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A TREATISE

ON THE LAW OF

COLLATERAL SECURITIES

AS APPLIED TO

NEGOTIABLE, QUASI-NEGOTIABLE,

AND

NON-NEGOTIABLE CHOSES IN ACTION.

BY

WM. COLEBROOKE.

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PREFACE.

The law and principles of collateral security, given for loans of money, discounts of bills of exchange or promissory notes, and other valuable considerations, have become a recognised branch of commercial jurisprudence. Occasional references to the subject are found in the text books, and the contract of pawn or pledge, as applied to corporeal personal property, is properly regarded as a division of the law of bailment. Different and more important questions arise, however, from the use of collateral securities, the term itself implying the existence of a principal promise or obligation of the borrower. The position of the indorsee of negotiable paper, receiving the same as collateral security, as a holder for value, in the usual course of business, and his rights, duties, and liabilities; and of the holder or indorsee of documents of title, such as certificates of stock, bills of lading, warehouse receipts, and other choses in action, as collateral; and of the borrower depositing such collateral security, require, for their proper consideration, a treatise exclusively devoted thereto. An endeavor has been made in this work, with more or less success, as the reader may judge, to cover the important questions indicated.

The natural division of collateral securities has been followed by an arrangement thereof into three general classes, including first, negotiable instruments, bills of exchange and promissory notes, bonds and coupons, notes (and bonds) and mortgage securities, and the rights, duties, and liabilities of the holder, creditor, surety, accommodation acceptor

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or indorser, or guarantor, holding collateral securities from the principal. The second, documents of title, which are, by commercial usage, quasi-negotiable, certificates of stock, bills of lading, and warehouse receipts; and the rights of stock and other brokers, dealing under the usages of Exchanges, with the collateral stocks and other securities of their customer, and of the factor as pledgor. The third class includes the large order of non-negotiable choses in action and equitable assignments of funds available as collateral.

The present work presents a complete citation of cases (over four thousand in number) directly relating to the law of collateral security, and including the latest published in the American and English reports.

WM. COLEBROOKE.

Chicago, Nov. 15, 1883.

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PART I.

NEGOTIABLE COLLATERAL SECURITIES.

CHAPTER I.

NEGOTIABLE COLLATERAL SECURITIES.

§1. The use of negotiable instruments as collateral security.
2. Definition of the terms "collateral security" and "collateral."
3. Recital of collateral securities in principal note.

§1. The use of Negotiable Instruments as Collateral security.—The use of negotiable instruments, as bills of exchange and promissory notes made by third persons, as collateral security for the payment of the negotiable promissory note or other obligation of the pledgor, where the same are indorsed, where required, or by delivery merely, where indorsed in blank and made payable to bearer, so that the pledgee becomes a party thereto, conveys the absolute legal title to such collateral securities, and if such transfer be made bona fide, before maturity, for value, without notice of equities, and in the usual course of business, the pledgee's title cannot be impeached. Holding the legal title to the negotiable collateral securities, a bona fide pledgee for value stands in the same position as to rights, privileges and equities, as a bona fide purchaser for value of negotiable instruments. The pledgee, with title, is a purchaser for value, and is entitled as any bona fide holder for value to enforce the collection of such negotiable collateral securities as against the parties to such notes for the full

amount of their face. The presumption of law in favor of the pledgee is, that he gave full value for them, or that he received them from some holder for value, to collect them, and to pay the principal debt at maturity from the proceeds, and hold any surplus for the benefit of the pledgor, or persons beneficially interested in such proceeds. The transaction by which the negotiable collateral securities pass to the lender, vests the legal title, and the only right of the pledgor is to redeem his collateral securities upon payment of the debt, or to be paid any surplus arising from their collection, after satisfaction of the pledgee's claims. By commercial usage, not only negotiable instruments, but also documents of title, quasi or non-negotiable in character, are available as collateral security for loans of money, or discounts of paper. The terms adopted, both in commercial circles and by jurists, describing such transactions—"collateral security" and "collateral," as distinguished from a mere pledge—illustrate the development of this special branch of the law, and emphasize the importance of the questions relative to the rights, duties, and liabilities incurred by parties to such contracts of loan, secured by collateral.[1]

§2. Definition of the terms "Collateral Security" and "Collateral." — "Collateral security" is a separate obligation, as the negotiable bill of exchange or promissory note of a third person, or document of title, or other representative of value, indorsed where necessary, and

[1] Railroad Co. *v.* National Bank, 102 U. S. 14; Swift *v.* Smith, Ib. 442; Collins *v.* Gilbert, 94 U. S. 753; Michigan Bank *v.* Eldred, 9 Wall. 544, 553; Gibson *v.* Stevens, 8 How, 384; Manhattan Co, *v.* Reynolds, 2 Hill, 140; Bank of New York *v.* Vanderhorst, 32 N. Y. 553; Crocker *v.* Crocker, 31 Ib. 507, 510; Farwell *v.* Importers' Bank, 90 Ib. 483; Chicopee Bank *v.* Chapin 8 Met. 40; De Wolf *v.* Gardner, 12 Cush. 19, 25; Logan *v.* Smith, 62 Mo. 455; Rice *v.* Dillingham, 73 Me. 59; Pierce *v.* Faunce, 49 Mo. 507; Miller *v.* Pollock, 99 Pa. St. 202; Richardson *v.* Rice, 9 Tenn. 290; Currie *v.* Misa, L. R. 10 Ex. 153; s. c. aff. 1 App. 554; Leask *v.* Scott, L. R. 2 Q. B. D., 376; Gill *v.* Continental Gas Co. L. R. 7 Ex. 332; ex parte Golding, L. R. 13 Ch. D. 634; France *v.* Clark, L. R. 22 Ch. D. 830; General Credit Co. *v.* Glegg, Ib. 549; Kemp *v.* Falk, L. R. 7 App. 582 (Blackburn, Lord).

delivered by a debtor to his creditor, to secure the payment of his own obligation, represented by an independent instrument. Such collateral security stands by the side of the principal promise as an additional or cumulative means for securing the payment of the debt.[1] The transfer, however, of the debtor's own negotiable promissory notes as collateral security for the payment of other notes made by him, does not come within any definition of collateral security;[2] nor where the proposed collateral security is a negotiable promissory note of a person already liable on a bill of exchange, the payment of which is to be secured.[3] "Collateral," in the commercial sense of the word, is a security given in addition to a principal obligation, and subsidiary thereto; and is used as generally descriptive of all choses in action, as distinguished from tangible personal property, including the usual negotiable instruments of commerce; the quasi-negotiable securities, as certificates of stock, bills of lading, and warehouse or cotton receipts; and the divers non-negotiable choses in action and equitable assignments available as collateral.

§3. Recital of Collateral Securities in Principal Note.—The regular course of banks and bankers in discounting commercial paper, to receive the promissory notes of third persons as collateral security for the payment of the principal note given by their customers, is a recognized form of collateral security.[4] Upon asking for such discount, it is

[1] Judge Redfield, in his note to LeBreton *v.* Pierce, 1 Am. Law Reg. (N. S), 38, says: "The etymology of collateral security indicates that it is something running along with, and as it were parallel to, something else of a similar character. It is collateral to the original indebtedness." Other definitions are found in Munn *v.* McDonald, 10 Watts, 273; Kramer *v.* Sandford, 4 W. & S. 328; Chambersburg Ins. Co. *v.* Smith, 11 Pa. St. 120; Shoemaker *v.* National Bank, 2 Abb. (U. S.) R. 416, 423; Lochrane *v.* Soloman, 38 Ga. 292; in re Athill, L. R. 16 Ch. D. 223. Bouv. Law Dict. 331.

[2] Miller *v.* Larned, 103 Ill. 562.

[3] Atlantic Bank *v.* Boies, 6 Duer, 583.

[4] Michigan Bank *v.* Eldred, 9 Wall. 544, 553; Railroad Co. *v.* National Bank, 102 U. S. 14.; ex parte Schofield, L. R. 12 Ch. D. 337, 348.

usual for the pledgor in his principal note to recite therein the collateral securities deposited, and the terms and manner in which the same may be sold or made otherwise available, upon default.[1] Such a recital does not affect the negotiability of the principal note, as the amount to be paid, the time, and the person to whom, remain certain.[2] Where a note, pledged as collateral security, recites on its face that it is "to be held as collateral security for the payment of certain notes" of third persons, it is non-negotiable, even in the hands of a bona fide indorsee, for value, lacking certainty in amount, and being a contingent promise.[3]

[1] "$—— ——— ——— 188—. * * * after date * * promise to pay to the order of * * * at its office in the city of * * * State of * * * * * * * dollars for value received, with interest at the rate of * * * per cent. per annum after due. As collateral security for the payment of this note, * * * have deposited with, and hereby pledge to said bank * * * and * * * * * * * hereby give the said * * * , its assign or assigns, authority to sell the same, or any part thereof, on the maturity of this note, or at any time thereafter, or before, in the event of the said securities depreciating in value, at public or private sale, without advertising the same, or demanding payment, or giving notice, and to apply so much of the proceeds thereof to the payment of this note as may be necessary to pay the same, with all interest due thereon, and also to the payment of all expenses attending the sale of the said * * * and in case the proceeds of the sale of the said * * * shall not cover the principal, interest and expenses, * * * promise to pay the deficiency forthwith after such sale; and * * hereby waive and release the holder of this note from all duty and diligence to sell, enforce, or collect any collateral held with this note. And it is hereby understood and agreed that the collateral upon this note shall be applicable to any other note or claim held by the said * * or the legal holder hereof, against * * , and in case of the exchange of or addition to the collateral above described, the provisions of this note shall extend to such new or additional collateral. * * ."

[2] Willoughby *v.* Comstock, 3 Hill, 389; Cook *v.* Satterlee, 6 Cow. 108; Arnold *v.* Rock River R. R. Co. 5 Duer, 207; National Bank *v.* Faut, 50 N. Y. 475; Banning *v.* Markham, 12 Gray, 454; Stultz *v.* Silva, 119 Mass 139; Towne *v.* Rice, 122 Ib. 67. Fancourt *v.* Thorne, 9 A. & E. 312; Bolton *v.* Dugdale, 4 B & Ad. 619; Wise *v.* Charlton, 4 A & E. 786.

[3] Haskell *v.* Lamber, 16 Gray, 592.

CHAPTER II.

THE ACT OF PLEDGE OF NEGOTIABLE COLLATERAL SECURITIES.

§4. By indorsement of negotiable bills and notes.
5. Where indorsed for collection or for a special purpose.
6. Pledge of negotiable instruments unindorsed.
7. By delivery when payable to bearer, or indorsed in blank.
8. And in the case of negotiable bonds and coupons.
9. Delivery of negotiable instruments in pledge essential.
10. Delivery may be to third party, by agreement.
11. The possession of collateral securities necessary to sustain pledge.
12. Applications of the rule as to possession.
13. Casey *v.* Cavaroc.
14. Collateral securities follow renewals of principal note.
15. Exchange or substitution of collateral securities.

§4. By Indorsement of Negotiable Bills and Notes. — The bona fide indorsee of negotiable bills and notes, receiving the same in the usual course of business, before maturity, as collateral security, for a valuable consideration, without notice, or if indorsed in blank or payable to bearer by mere delivery, is a holder for value, and as much within the protection and benefits of the law-merchant as if the transfer were by way of absolute sale.[1] The

[1] Railroad Company *v.* National Bank, 102 U. S. 14, 37; Oates *v.* National Bank, 100 Ib. 239, 247, 248; Manhattan Co. *v.* Reynolds, 2 Hill, 140; Poughkeepsie *v.* Hasbrouck, 6 N. Y. 230; Nelson *v.* Eaton, 26 Ib. 410; City Bank *v.* Perkins, 29 Ib. 554; Nelson *v.* Wellington, 5 Bos. W. 187; Munn *v.* McDonald, 10 Watts, 273; Hunt *v.* Nevers, 15 Pick. 500; Taylor *v.* Williams, 11 Met. 44; Logan *v.* Smith, 62 Mo. 455; Savings Assn. *v.* Hunt, 17 Kan. 532; Best *v.* Crall 23 Ib. 484; Allen *v.* King, 4 McLean C. C. 128. The only cases contra are in New Hampshire: Jenness *v.* Bean, 10 N. H. 266; Williams *v.* Little, 11 Ib. 60; Clement *v.* Everett, 12 Ib. 317; *see* Tucker *v.* Bank, 58 Ib. 83. Peacock *v.* Purcell, 14 C. B.

holder of such bill and notes negotiated as collateral, security in either case, assumes the responsibility, if not paid when due and payable, of making demand of payment and of giving notice of non-payment, as may be necessary. The assumption of this liability by the holder of negotiable paper as collateral security, is a valuable consideration of itself to support his position as a holder for value, in the usual course of business, in cases where there has been a present advance, or a surrender of other securities, or a valid antecedent debt, or other valuable consideration.[1]

§5. Where Indorsed for Collection, or for a Special Purpose.—The indorsement of a bill of exchange, or note of a third person, deposited in a bank, may be shown to have been made conditionally, or for a special purpose, and not with the intention to convey the title. It may be shown that such indorsement was made simply to enable the bank, or other agency, to make collection thereof for the customer. In such cases, the title to the securities remains in the customer, and in the event of the bank's insolvency, the specific notes may be recovered, or the avails thereof.[2] The negotiation, however, of bills or notes, for value, before maturity, by the person or bank holding the same for purposes as stated, to persons paying value therefor in good faith, without notice of equities, defeats the claim of the owner to recover his property.[3] If the paper be

N. S. 728; in re European Bank, L. R. 8 Ch. 41; Collins *v.* Martin, 1 B. & P. 648; Palmer *v.* Richards, 15 W. Jur. 41.

[1] Railroad Co *v.* Nat. Bank, 102 U. S. 14.

[2] Ex parte Twogood, 19 Ves. 231; In re Boys, L. R. 10 Eq. 467; Solomon *v.* Bank of England, 15 East. 135; De La Chaumette *v.* Bank of England, 9 B. & C. 208; Scott *v.* Ocean Bank, 23 N. Y. 289; Johnson *v.* Barney, 1 Ia., 531; Atkinson *v.* Brooks, 26 Vt. 584; Moore *v.* Hall, 48 Mich. 143; Boyd *v.* Corbitt, 37 Ib. 52; Balback *v.* Frelinghuysen, 15 Fd. Rep. 675, s. c. 15 Rep. 518.

[3] Ex parte Twogood, supra; ex parte Schofield, L. R. 12 Ch. D. 337. Palmer *v.* Richards, 1 E. L. & E. 529; 15 Jur. 41; Lloyd *v.* Howard 20 L. J. Q. B. 1; Balback *v.* Frelinghuysen, *supra.*

taken after maturity, although value is paid therefor, it is subject to equities.[1] The presumption is that a bill of exchange given for a certain sum, and payable at a certain day, was negotiated for a present advance, and a banker is not allowed to retain the bill of exchange as a continuing guaranty, without proof that such was the agreement.[2]

§6. Pledge of Negotiable Instruments, Unindorsed.—A simple delivery of negotiable promissory notes or bills of exchange as collateral security, where indorsement is required, so that the title to the securities still remains in the pledgor, vests in the pledgee a contingent equitable interest only, or in the proceeds thereof, subject to the prior equities of third persons as against the pledgor.[3] The pledgee, under such circumstances, is the mere agent of the pledgor, and no reason exists for excluding equities existing against the pledgor.[4] Such collateral securities stand upon the same footing as non-negotiable paper, subject to all defenses, equities and infirmities existing at the time of assignment between the payee and the maker, whether attached to the instrument or not.[5] Where a bill of exchange was deposited as collateral security, without proper indorsement, and the pledgor became bankrupt, the pledgee was given the aid of equity to require the pledgor's assignee to make the necessary indorsement.[6] Under the Louisiana statutes, delivery of negotiable securities is sufficient to constitute a valid act of pledge, and a deposit of bills of exchange, bills receivable, notes, and other securities, unindorsed, is supported.[7]

[1] Foley *v.* Smith, 6 Wall. 493.

[2] In re Boys, L. R. 10 Eq. 467.

[3] Snow *v.* Fourth Nat Bank, 7 Robt. 479.

[4] Palmer *v.* Richards, 1 E. L. & E. 529; De La Chaumette *v.* Bank of England, 9 B & C. 208; Atkinson *v.* Brooks, 26 Vt. 569; Allen *v.* King, 4 McLean, 128.

[5] Simpson *v.* Hall, 47 Conn. 417.

[6] Ex parte Rice, 3 M. D. & D. 586.

[7] Casey *v.* Schneider, 95 U. S. 497; Partee *v.* Corning, 9 La. Ann. 539; Act of Louisiana, March 15, 1855; Rev. Stats. Lou. 1876, § 2904.

§7. By Delivery when Payable to Bearer, or Indorsed in Blank.—The possession of valid negotiable instruments indorsed in blank, or made payable to bearer, is prima facie evidence that the holder has full title thereto. This rule is applied in favor of the holder of negotiable instruments, so drawn or indorsed, as collateral security.[1] "A note (as said by Judge Story, in Bullard *v.* Bell)[2] is often said to be assignable by delivery; but, in correct language, there is no assignment in the case. It passes by mere delivery; and the holder never makes any title by or through any assignment, but claims merely as bearer. The note is an original promise by the maker to pay any person who shall become the bearer; it is therefore payable to any person who successively holds the note bona fide, not by virtue of any assignment of the promise, but by an original and direct promise, moving from the maker to the bearer."

§8. And in the case of Negotiable Bonds and Coupons.—Negotiable bonds, payable to bearer or "holder," issued under statutory authority, by municipalities or corporations, are negotiable instruments, the title to which passes by delivery. The delivery of such bonds by the pledgor to the pledgee, as collateral security, before ma-

[1] Railroad Company *v.* Nat. Bank, supra, p. 38; Bank of Kentucky *v.* Wister, 2 Pet. 326; Goodman *v.* Simonds, 20 How. 343, 365; Wheeler *v.* Guild, 20 Pick. 545; Magee *v.* Badger, 34 N. Y. 247; Maitland *v.* Citizens Nat. Bank, 40 Md. 540, 564; Blanchard *v.* Stevens, 3 Cush. 162, 167; Stoddard *v.* Kimball, 6 Ib. 469; Pettee *v.* Prout, 3 Gray, 502; Way *v.* Richardson, Ib. 412; Stone *v.* Brown, 54 Tex. 330; Thomson *v.* Lee County, 3 Wall. 331; Bushnell *v.* Kennedy, 9 Ib. 391; City of Lexington *v.* Butler, 14 Ib. 293; Town of Thompson *v.* Perrine, 106 U. S. 259; Cooper *v.* Thompson, 13 Blatchf. 434; Coe *v.* Railroad Co., 19 Ib. 522; Fitch *v.* Jones, 5 El. & Bl. 238; Smith *v.* Braine, 16 A. & El. N. S. 242; Hall *v.* Featherstone, 3 H. & N. 282; Chitty, Bills, 229, says: "A blank indorsement constitutes by itself a complete and perfect transfer of the interest in the bill or note, and without the addition of any other words will vest the right of action and all other rights in the transferee and subsequent holders."

[2] 1 Mason, 251; Town of Thompson *v.* Perrine, 106 U. S. 259.

turity, for a valuable consideration, vests the full legal and equitable title in the latter.[1] The same rule applies to dissevered coupon notes or warrants issued with bonds payable to bearer. When separated from the bond, such coupons cease to be mere incidents of the bonds, and become independent negotiable instruments, the title to which passes by delivery.[2]

§9. Delivery of Negotiable Instruments in Pledge Essential.—Delivery of negotiable instruments, to be held as collateral securities, is an essential condition of the validity of the act of pledge. In this respect there is no difference between a pledge of personal property and one of negotiable securities.[3] This rule is enforced under the Louisiana code, where a firm, having made certain accommodation indorsements upon the promise of receiving security, were asked to call at the office of the obliged party for the bills, but neglected to do so until the pledgor deceased. There having been no delivery, the accommodation indorsers, although liable upon the bills, had no claim

[1] Goodman *v.* Simonds, 20 How. 452; Murray *v.* Lardner, 2 Wall. 110; Jerome *v.* McCarter, 94 U. S. 734; Hotchkiss *v.* National Banks, 22 Wall. 354; Hackett *v.* Ottawa, 99 U. S. 86; Ottawa *v.* National Bank, 105 Ib. 342; Robert *v.* Bolles, 101 Ib. 119; Ins. Co. *v.* Bruce, 105 Ib. 328; State of Illinois *v.* Delafield, 8 Paige, 527; s. c. 2 Hill, 159, 177; Bank of Rome *v.* Village, 19 N. Y. 20; Brainard *v.* N. Y. etc. R. R. Co. 25 N. Y. 496; Royal Bank *v.* Grand Junction Ry. Co. 100 Mass. 444; Morris Canal and Banking Company *v.* Lewis, 12 N. J. Eq. 322; same *v.* Fisher, 9 Ib. 667; Johnson *v.* County of Stark, 24 Ill. 75; Third National Bank *v.* Boyd. 44 Md. 47; Gorgier *v.* Mieville, 3 B. & C. 45.

[2] Walnut *v.* Wade, 103 U. S. 696; Clark *v.* Iowa City, 20 Wall. 583; Aurora City *v.* West, 7 Ib. 82; Thompson *v.* Lee County, 3 Ib. 327; Cromwell *v.* County of Sac, 94 U. S. 351, 362; Brooklyn *v.* Ins. Co. 99 U. S. 362; County of Beaver *v.* Armstrong, 44 Pa. St. 63; Nat. Exch. Bank *v.* Hartford, etc., Ry. Co. 8 R. I. 375; Johnson *v.* Stark Co., 24 Ill. 75; Town of Eagle *v.* Kohn, 84 Ib. 292; Pettee *v.* Prout, 3 Gray, 502; Evertson *v.* National Bank, 66 N. Y. 14; Haven *v.* Railroad Co., 109 Mass. 88.

[3] Casey *v.* Schneider, 96 U. S. 497; Huker *v.* Bullard, 2 La. Ann. 338; Partie *v.* Corning, 9 Ib. 539.

upon the proposed securities.[1] Delivery in pledge, where the securities are already in possession of the person by whom the loan is to be made, may be provided for by verbal agreement.[2] A promissory note having been pledged as collateral to secure the payment of a debt, which was afterwards paid, the collateral note remaining in the hands of the pledgee, a letter from the pledgor stating that he had arranged for an extension of time, and asking the pledgee for time upon another debt, to hold the collateral note as security therefor, is an actual pledge, and not a mere offer to pledge, delivery and possession to the pledgee having theretofore been made.[3] And notice to a pledgee, holding securities for a debt less than the value thereof, of a pledge of the surplus, is sufficient to make a valid contract.[4]

§10. Delivery may be Made to Third Person, by Agreement.—Such delivery of negotiable instruments as collateral security may, by agreement of the parties, be made to a third person. Such delivery is sufficient to constitute a valid pledge.[5] The negotiable collaterals should be properly indorsed before delivery to such third person, so that upon default in payment of the principal debt, the pledgee may be able to enforce their payment.[6] Where bills receivable were thus placed in posession of a third party, to hold as collateral security for the benefit of the pledgee, and exchanges of such collaterals were made, and a new note given, and upon the insolvency of the pledgor the collaterals were handed to the pledgee, his right of

[1] D'Meza's Succ. 26 La. Ann. 35; Lou. Rev. Stats. 1,876, §2 904.

[2] Van Blarcom *v.* Broadway Bank, 37 N. Y. 540; Brown *v.* Warren, 43 N. H. 430; Sanders *v.* Davis, 13 B. Monr. 432.

[3] Providence Thread Co. *v.* Aldrich, 12 R. I. 77.

[4] Portalis *v.* Tetley, L. R. 5 Eq. 140.

[5] Rev. Civ. Code, Lou. Art. 3162.

[6] Bank of Chenango *v.* Hyde, 4 Cow. 567.

recovery against the parties thereto was fully sustained, notwithstanding a claim that the loan itself was illegal.[1]

§11. The Possession of Collateral Securities Necessary to sustain Pledge.—The holder of negotiable instruments as collateral security, receiving the same so as to become a party thereto, does not lose his right and title thereto, nor to the proceeds thereof, by a redelivery of the same to the pledgor where such a delivery is made with the intention or upon the agreement that the pledgor shall proceed, for and on behalf of the pledgee, to make collection thereof, or do some other proper and necessary act in respect thereto. Where collection of collaterals is the object, the pledgor is regarded as the representative or agent of the pledgee. He acts in a fiduciary character, and the funds which he may collect upon such collaterals, are the property of the pledgee, to be credited upon the principal debt.[2] The redelivery of negotiable securities to the pledgor, with the intention not only to facilitate collection thereof, but also under an agreement authorizing him upon redelivery to exchange or substitute other collaterals, the exchange being made several times, and the principal notes being also renewed, does not affect the title to the securities vested in the pledgee by proper indorsement.[3]

[1] City Bank *v.* Perkins, 29 N. Y. 554.

[2] White *v.* Platt, 4 Denio, 269; Hays *v.* Riddle, 1 Sandf. 248; Pier *v.* Bullis, 48 Wis. 429; Whipple *v.* Blackington, 97 Mass. 476; Tiffany *v.* Boatmen's Inst. 18 Wall. 375; Clark *v.* Iselin, 21 Ib. 360; Dodge *v.* Bank, 2 MacAr. 420; Hurst *v.* Coley, 15 Fed. Rep. 645; Stern *v.* Germania Nat. Bank, 34 La. Ann. 1119. In White *v.* Platt, supra, promissory notes, some of them overdue, made by parties in Ohio, were pledged as collateral security in New York, properly indorsed. They were redelivered to the pledgor, to be taken to Ohio, there to be collected if possible, or to obtain security for their payment. A delivery for such purpose did not affect the pledgee's claim to the notes, or the money collected, to the extent of the debt for which the notes were pledged.

[3] Clark *v.* Iselin, 21 Wall. 360.

§12. Applications of the Rule as to Possession. —The title acquired by a bona fide pledgee for value of negotiable collateral securities, such as coupon bonds, is not defeated although the act of pledge itself was a misappropriation, where the repossession of the securities was obtained by the pledgor by false representations. The equity of the pledgee, who has advanced funds in good faith, is preferred as against the real owner of the securities.[1] But the claims of a pledgee were denied in a case where collateral securities, held by a bank as general security for all liabilities, were at different times, with permission of the cashier, allowed to be removed and others substituted, and in one instance a negotiable security so received was sold by the pledgor to a bona fide purchaser for value, without notice. The security thus sold was retained by the pledgor under an agreement to collect the interest thereon, and was returned by him to the bank, and placed in a package with the other securities. Other loans were made upon the securities, but without regard to this particular security. Upon default, the bank's claim upon the collateral securities as against the bona fide purchaser, for value, without notice of the agreement appropriating all collaterals deposited by the pledgor as security, was not favored.[2] And the pledgee, who has redelivered the collateral securities held by him to the pledgor, for the purpose that he may collect the same, may, upon a failure of the pledgor, upon demand, to return such collaterals or to account for the proceeds thereof, bring an action of trover, and recover the value of his interest therein, which will be the amount of his debt where the collaterals are greater in value, or the whole value where less.[3]

§13. Casey vs. Cavaroc. — The importance of continued possession, as well as delivery, of negotiable instru-

[1] Ringling *v.* Kohn, 4 Mo. App. 59.
[2] Wyeth *v.* Bank, 132 Mass. 597.
[3] Hurst *v.* Coley, 15 Fed. Rep. 645.

ments used as collateral security, in order to constitute a valid act of pledge as against third parties, is illustrated in the case of Casey *v.* Cavaroc,[1] although the decision itself was based particularly upon the provisions of the Louisiana Code. A New Orleans bank arranged for the acceptance of its bills of exchange, the obligation being guaranteed by its president, and secured payment thereof by a pledge of its bills receivable, under an agreement that they were to be held by a banking firm of which the president was principal. A formal delivery of the securities, unindorsed, was made, but they were at once placed in a separate envelope, and returned to the cashier of the bank. Collections were made of the securities, under the agreement, by the bank for its own benefit, other bills being substituted, and renewals and changes made, the securities continuing to be kept separately from others. No entry of the pledge was made on the books of the bank, and the securities were included in the daily and monthly official statements of its condition. The bank stopped payment, and after the failure the president took possession of the package of securities, obtained the indorsement of the bank upon the bills, and then formally placed the securities in the possession of his firm. The United States Supreme Court regarded the act of pledge as not completed, and as against creditors of the pledgor, or a receiver appointed under the National Bank Act, the continued possession and control of the securities by the pledgor, the representations contained in the official statements of its officers, and the other facts stated, defeated any claims arising under the contract of pledge.

[1] 96 U. S. 467; Casey *v.* National Bank, Ib. 492, and Casey *v.* Schuchardt, Ib. 494, are to like effect, reversing same cases, 2 Woods C. C. 77. In Casey *v.* Schneider, 96 U. S. 497, securities were deposited with the New Orleans clearing house association as security for the payment of clearing house certificates issued to the bank, and were held in continued possession by the trustees. In this case the claims of the pledgee were preferred.

§14. Collateral Securities follow Renewals of Principal Note.—The renewal of a negotiable bill or note representing the principal indebtedness, for the payment of which collateral securities have been deposited, does not affect the right of the creditor to retain or enforce the collaterals. He is equally entitled to the benefit of the collateral securities as a means of obtaining payment of the note or bill given in renewal as in the case of the original evidence of indebtedness.[1] Where "short" paper is taken as collateral security, it involves rather its renewal, or the substitution of other securities than its collection.[2] But where a note is pledged as collateral security, under circumstances as to the original debt which fails to make the pledgee a holder for value, a renewal of the note is subject to the same objection. The transaction is regarded simply as a prolongation of the original contract.[3]

§15. Exchange or Substitution of Collateral Securities.—The exchange or substitution of other securities for those originally delivered as collateral, has no effect upon the rights of the pledgee, as founded upon the original contract. The surrender of the securities originally depos-

[1] Jones *v.* Guaranty Co., 101 U. S. 622; Worcester Nat. Bank *v.* Cheeney, 87 Ill. 702; Cherry *v.* Frost, 7 Lea, 11; Collins *v.* Dawle, 4 Col. 138; Burton *v.* Peterson, 12 Phila. 397; Shaw *v.* Clark, 49 Mich. 384; Cover *v.* Black, 1 Barr, 493; Lytle's App. 36 Pa. St. 131; Shrewsbury Savings Inst. App. 94 Pa. St. 309; Brinkerhoff *v.* Lansing, 4 Johns. Ch. 65, 73; Merchants' Nat. Bank *v.* Hall, 83 N. Y. 338; Agawam Bank *v.* Strever, 18 Ib. 502; Davis *v.* Maynard, 9 Mass. 242; Watkins *v.* Hill, 8 Pick. 522; Pomeroy *v.* Rice, 16 Ib. 22; Taber *v.* Hamilton, 97 Mass. 489; Patterson *v.* Johnson, 7 Ohio, 225; Dayton Nat. Bank *v.* Merchants' Nat. Bank, 37 Ohio St. 208; Reddish *v.* Watson, 6 Ham. (Ohio) 510; N. H. Savings Bank *v.* Gill, 16 N. H. 578; First Nat. Bank *v.* Bates, 1 Fed. Rep. 502; s. c. 19 A. L. R. (N. S.) 566; Ex parte Price, 3 M. D. and D. 586; Combe *v.* Wolff, 8 Bing. 156: Howell *v.* James, 1 Cr. M. and R. 97. The renewal of a note given as collateral security for a pre-existing debt, does not, in Maine, constitute the pledgee a holder for value in the usual course of business. Nutter *v.* Storer, 48 Me. 163; Bramhall *v.* Beckett, 31 Ib. 265.

[2] Girard Fire Ins. Co. *v.* Marr, 46 Pa. St. 504.

[3] Roger *v.* Keystone Nat. Bank, 93 Pa. St. 248.

ited is a valuable consideration for the giving of the new securities, and the pledgee is as to the latter a holder for value, in the usual course of business.[1] Such exchange and substitution is sometimes of the utmost benefit to the pledgor, and is supported as against creditors, for the reason that they are not harmed thereby.[2] Even after a pledgor is known to be insolvent, such exchange and substitution of securities is valid, if made bona fide, the pledgee receiving securities of no greater value than those surrendered.[3] The pledgee of negotiable securities, made by third parties, and holding the title thereto, may exchange them for other securities of like value from such parties, without the consent of the pledgor, although if this be done, the pledgee assumes an increased responsibility. Taking a security for a less amount, unless explained, renders the pledgee liable.[4] All that is required of the pledgee in such exchange of securities, is proper care and diligence.[5]

[1] Clark *v.* Iselin, 21 Wall. 360; Greenwell *v.* Hayden, 78 Ky. 534; Cherry *v.* Frost, 7 Lea, 1, 11; Blackburn Bldg. Society *v.* Cunliff, L. R. 22 Ch. D. 61.

[2] Sawyer *v.* Turpin, 91 U. S. 114, 121.

[3] Cook *v.* Tullis, 18 Wall. 340; Tiffany *v.* Boatmen's Saving Inst., Ib. 375; Clark *v.* Iselin, 21 Ib. 360; Watson *v.* Taylor, Ib. 378; Burnhisel *v.* Firman, 22 Ib. 170; Sawyer *v.* Turpin, 91 U. S. 114, 121; in re Swenk, 9 Rep. 643; Stevens *v.* Blanchard, 3 Cush. 169; Abbott *v.* Pomfert, 1 Bing. N. C. 462.

[4] Girard Ins. Co. *v.* Marr, 46 Pa. St. 504. The court say: "The mere exchange of the securities is not sufficient to establish loss to the owners of the collaterals by the exchange." One of the pledgers informed the pledgee that if the securities were exchanged by them, they "would have to renew them at their risk, and take them as cash." The court say: "This warning does not establish ipse facto a loss by reason of the exchange. They could not thus change the terms of the pledge."

[5] Bank of U. S. *v.* Peabody, 20 Pa. St. 454; Muirhead *v.* Kilpatrick, 21 Ib. 237; Seller *v.* Jones, 22 Ib. 423; Girard Life Ins. Co. *v.* Marr, supra.

CHAPTER III.

THE PLEDGEE A HOLDER FOR VALUE.

§16. The pledgee of negotiable collateral securities for present advance a holder for value.
17. Negotiable securities as collateral for future advances.
18. The pledgee of negotiable collateral securities, for an antecedent debt, without more, a holder for value.
19. The decisions of the United States Supreme Court.
20. Railroad Company *v.* National Bank.
21. The contra state rule not followed.
22. The rule in England.
23. The contra rule—the pledgee for an antecedent debt, without more, not a holder for value.
24. The New York rule as to pledge for antecedent debt.
25. The rule in Missouri.
26. The rule in Ohio and other states.
27. The pledgee for antecedent debt, with new consideration, a holder for value.
28. Transfer in payment of antecedent debt.
29. Such transfer is prima facie as collateral security.
30. The rule in Massachusetts and Vermont.

§16. THE PLEDGEE OF NEGOTIABLE COLLATERAL SECURITY FOR PRESENT ADVANCE, A HOLDER FOR VALUE. —The pledgee of negotiable instruments, as bills of exchange and promissory notes, before maturity, by indorsement and delivery, so that he becomes a party thereto, for a present advance, and as a part of the transaction of loan, and without notice of antecedent equities, is a holder for value in the due course of business.[1]

[1] Lehman *v.* Tallahassee Man. Co. 64 Ala. 567; Miller *v.* Pollock, 99 Pa. St. 202; Plotts *v.* Byers, 17 Ia. 303; State Savings Assn. *v.* Hurst, 17 Kan. 532; Best *v.* Crall, 23 Ib. 482; Logan *v.* Smith, 62 Mo. 455;

While such collateral security is not regarded as the principal foundation for the advance, yet the pledgee parts with his money upon the faith that the collateral notes will be paid in the event that the principal note is not; and, having parted with value upon receiving such collateral notes, is a holder for value thereof.[1] A loan of money to one insolvent upon collateral securities pledged at the time of the loan, if the same be free from fraud, and even if the lender has reason to believe the borrower is insolvent, is a valid transaction, and the pledgee may retain the securities until the debt is paid. The power to raise ready money under such circumstances may be of great value to the borrower.[2]

Duncombe *v.* R. R. Co., 84 N. Y. 190; Richardson *v.* Campbell, 48 N. Y. 348; Williams *v.* Smith, 2 Hill, 301; Ferden *v.* Smith, 2 E. D. Smith 106; Bank of N. Y. *v.* Vanderhorst, 32 N. Y. 553; Farwell *v.* Importer's Bank, 90 N. Y. 483; Holbrook *v.* Bassett, 5 Duer. 147; Brookman *v.* Metcalf, Ib. 429; Van Blarcum *v.* Broadway Bank, 37 N. Y. 540; Munn *v.* McDonald, 10 Watts, 270; Brown *v.* Warren, 43 N. H. 430; Chicopee Bank *v.* Chapin, 8 Met. 40; Tarbell *v.* Sturtevant, 26 Vt. 513; Griswold *v.* Davis, 31 Vt. 390; Bond *v.* Wiltze, 12 Wis. 611; Crosby *v.* Roub, 16 Ib. 616; Lyon *v.* Ewings, 17 Ib. 61; Curtis *v.* Mohr, 18 Ib. 615; Bowman *v.* VanKuren, 29 Ib. 219; Louisiana State Bank *v.* Gaienne, 21 La. Ann. 555; Mechanics' Assn. *v.* Ferguson, 29 La. 549; Hotchkiss *v.* Nat. Banks, 22 Wall. 354; Tiffany *v.* Boatmen's Inst. 18 Ib. 375; Michigan Bank *v.* Eldred, 9 Ib. 544, 553; Railroad Co. *v.* National Bank, 102 U. S. 14 25. The Court (Harlan, J.) say: "It may be regarded as settled in commercial jurisprudence —there being no statutory regulation on the subject—that where negotiable paper is transferred by indorsement, as collateral security for a debt created, or a purchase made, at the time of the transfer * * * the holder who takes the transferred paper, before its maturity, and without notice, actual or otherwise, of any defence thereto, is held to have received it in due course of business, and, in the sense of the commercial law, becomes a holder for value, entitled to enforce payment, without regard to any equity or defence which exists between prior parties to such paper."

[1] Bank of New York *v.* Vanderhorst, 32 N. Y. 553; Miller *v.* Pollock, 99 Pa. St. 202.

[2] Tiffany *v.* Boatmen's Inst. 18 Wall. 376, 388; Cook *v.* Tullis, Ib. 340; Wilson *v.* City, 17 Ib. 375; Mays *v.* Fritton, 20 Ib. 414; Clark *v.* Iselin, 21 Ib. 360; Watson *v.* Taylor, Ib. 378; Burnhisel *v.* Firman, 22 Ib. 170; Sawyer *v.* Turpin, 91 U. S. 114; Jerome *v.* McCarter, 94 Ib. 734; Hutton *v.* Crittwell, 1 El. & Bl. 15;

The rule that the pledgee of negotiable instruments, properly indorsed and delivered, receiving the same as collateral security for a present advance, is a holder for value, is illustrated by the favor shown him in common with other holders for value of negotiable paper. Payments made by an acceptor of a bill of exchange to the pledgor thereof, who had previously indorsed the bill as security for a present advance, do not affect the right of the pledgee to recover the whole amount of the bill.[1] Nor will the fact that notes, tainted with illegality, were pledged as collateral security for other notes discounted, the money on which was paid over, and the indorsement of the notes was made for the purpose of cutting off the equities of the maker, be any defence against the pledgee, without notice, and claiming under a bona fide advance.[2] Pledges of negotiable bonds by a corporation to its directors and also to bankers, for present advances, constitute them holders for value.[3] A pledgee of bills of exchange, made for approximate amounts, upon which advances were made, and for which drafts for the actual amounts were afterwards substituted, is preferred to a representative of other creditors, appointed before the drafts were actually paid.[4] Upon an agreement to deposit securities at the time the advance is made, a subsequent delivery of them is enough to make the pledgee a holder for value upon a present advance.[5]

§17. Negotiable Securities as Collateral for Future Advances.—The pledgee of negotiable instru-

Bittleston *v.* Cook, 6 Ib. 296; Harris *v.* Rickett, 4 H. & N. 1; Bell *v.* Simpson, 2 Ib. 410; Hunt *v.* Mortimer, 10 B. & C, 44; ex parte Sharse, Crabbe, 482; Wadsworth *v.* Tyler, 2 B. R. 101; Lee *v.* Hart, 11 Exch. 880; Pennell *v.* Reynolds, 11 C. B. N. S. 709.

[1] Savings Assn. *v.* Hunt, 17 Kan. 532.

[2] Third Nat. Bank *v.* Harrison, 10 Fed. Rep. 243.

[3] Lehman *v.* Tallahassee Mang. Co. 64 Ala 567; Duncombe *v.* R. R. Co., 88 N. Y. 1; s. c. 84 N. Y. 190; Claflin *v.* South Carolina R. R. Co., 4 Hughes, 12.

[4] Young *v.* Northern Ill. etc. Assn. 9 Biss. 300.

[5] Fenby *v.* Pritchard, 2 Sandf. 151.

ments as collateral security under valid agreements stipulating for future advances or loans, receiving the same so as to become a party thereto, before maturity, without notice, is a holder for value in the usual course of business.[1] Such contracts of collateral security for the payment of future advances are regarded as in the nature of equitable mortgages, and are binding, as between the parties, for any and all advances made thereon prior to notice of claims of third parties.[2] An exception to the general rule is found in a Tennessee decision, where the same rule is applied to negotiable paper taken as collateral security for future advances, as when given for antecedent indebtedness, the holder receiving it as though he were a transferee of over-due paper, subject to the equities existing at the time of the transfer, but not those arising subsequent thereto.[3]

The rule in favor of the pledgee receiving such securities before maturity for future advances, without notice of equities, is supported in cases where the act of pledge is a misappropriation. A banker holding promissory notes simply for the purpose of collecting interest thereon, but which were indorsed in blank, pledged the same with his Chicago correspondent, as security for his then indebtedness and future advances, and subsequently became insolvent. The pledgee having acquired the same in good faith, in the usual course of business, from one invested with the evidence of title, the owner must suffer the loss resulting from misplaced confidence.[4] One of several partners indorsed a promissory note payable to the firm, as security for future advances to another firm, of which he was a member, with others, the transfer being an act of misappropriation. The first firm subsequently became insolvent. In a

[1] Dayton Nat. Bank *v.* Merchants Nat. Bank, 37 Ohio St. 208, 217; Davis *v.* Randall, 115 Mass. 547; Merchants' Nat. Bank *v.* Hall, 83 N. Y. 338; Agawam Bank *v.* Strever, 18 Ib. 502; Calkins *v.* Lockwood, 16 Conn. 287; Buchanan *v.* International Bank, 78 Ill. 500; Heywood *v.* Watson, 4 Bing. 496.

[2] Walker *v.* Lee, 15 S. C. 142.

[3] Richardson *v.* Rice, 9 Baxt. 290.

[4] Morris *v.* Preston, 93 Ill. 215.

contest between its creditors and the holders of the note as collateral, the claims of the latter were enforced.[1]

§18. The Pledgee of Negotiable Collateral Securities for an Antecedent Debt, without more, a Holder for Value.—The pledgee of negotiable instruments, properly indorsed and delivered (where indorsement is required) or by delivery only where indorsed in blank or made payable to bearer, so that he becomes a party thereto, receiving the same before maturity, in good faith, and without notice of equities, as collateral security for a valid antecedent debt, without more, is a holder for value in the usual course of business.[2] Such pledgee, holding

[1] Walker *v.* Lee, supra.

[2] Swift *v.* Tyson, 16 Pet. 1; Goodman *v.* Simonds, 20 How. 373; McCarty *v* Roots, 21 How. 430; Sawyer *v.* Prichett, 19 Wall. 166; Oates *v.* Nat. Bank, 100 U S. 239; Railroad Co. *v.* Nat. Bank, 102 U. S. 14; Pugh *v.* Durfee, 1 Blatch. 412; Third Nat Bank *v.* Harrison. Cir. Ct. E. D. Mo. 1882, 10 Fed. Rep. 243; Allen *v.* Dallas etc. Ry. Co., 3 Woods, C. C. 316, 325; Robinson *v.* Smith, 14 Cal. 94; Payne *v.* Beasley 8 Ib. 266; Davis *v.* Russell, 52 Ib. 611; Sackett *v.* Johnson, 54 Ib. 107; Roberts *v.* Hall, 37 Conn. 205; Bridgeport City Bank *v.* Welch, 29 Ib. 475; Savings Bank *v.* Bates, 8 Ib. 505; Brush *v.* Scribner, 11 Ib. 388; Gibson *v.* Conner, 3 Ga. 47; Meadow *v.* Bird, 22 Ib 246; Bond *v.* Central Bank, 2 Kelly, 106; Manning *v.* McClure, 36 Ill. 490; Butters *v.* Haughwert, 42 Ill. 18; Doolittle *v.* Cook, 75 Ib. 354; Mix *v.* Bank, 91 Ill. 20; Morris *v.* Preston 93 Ib. 215; Miller *v.* Larned, 103 Ib. 562; McIntire *v.* Yates, 104 Ill. 491; First Nat. Bank *v.* Beard, 3 Bradw. 239; Vallette *v.* Mason, 1 Ind. 89; Work *v.* Brayton, 5 Ib. 396; Babcock *v.* Jordan, 24 Ib. 14; Straughan *v.* Fairchild, 80 Ib. 598; Grovanovich *v.* Citizen's Bank, 26 La. Ann. 15. Maryland: Maitland *v.* Citizens Nat. Bank, 40 Md. 540; Fisher *v.* Fisher, 90 Mass 303; Paine *v.* Furnas, 117 Mass. 290; Chicopee Bank *v.* Chapin, 8 Met. 40; Blanchard *v.* Stevens, 3 Cush. 16; Gardner *v.* Guager, 1 Allen, 502; LeBreton *v.* Pierce, 2 Ib. 14; Stoddard *v.* Kimball, 6 Cush. 469; Culver *v.* Benedict, 13 Gray, 11; Putnam *v.* Story, 132 Mass. 205; Allaire *v.* Hartshorne, 21 N. J. L. 665; Amos *v.* M'Michael, 36 Ib. 92; Bank *v.* Carrington, 5 R. I. 515; Cobb *v.* Doyle, 7 Ib. 550; Bank *v.* Chambers, 11 Rich. (S. C.) 657; Greeneaux *v.* Wheeler, 6 Tex. 515; Alexander Ry. Co. *v.* Burke, 22 Gratt. 254. The paper must be taken in good faith, and without notice of anything to impeach its validity. Chicopee Bank *v.* Chapin, 8 Met. 40; Stoddard *v.* Kimball, 6 Cush. 469; Culver *v.* Benedict, 13 Gray, 11; Stevens *v.* Blanchard, 3 Cush. 162. And the

negotiable instruments as collateral security for a valid indebtedness, payment of which he is at once entitled to enforce, and receiving such negotiable collateral securities so as to become a party thereto, is charged with the responsibilities and liabilities of making proper demand and of giving notice of non-payment of them upon default. The assumption of this duty and the implied promise of delay in the enforcement of the original indebtedness by the receipt thereof, furnishes a valuable consideration to support such transfer of negotiable instruments as collateral security for an antecedent debt, and brings the transaction clearly within the ordinary and usual course of business. The rule, as above stated, is approved by the Supreme Court of the United States and the Federal Courts, and by the courts of last resort in the following States: California, Connecticut, Georgia, Illinois, Indiana, Louisiana, Maryland, Massachusetts, New Jersey, Rhode Island, South Carolina, Texas, and Virginia; and in England and Canada.[1]

§19. The Rule, as announced by the United States Supreme Court.—The first leading case in the Supreme Court of the United States, in which the title of the holder for value of negotiable instruments as collateral security for a pre-existing debt, without more, was discussed, was Swift *v.* Tyson,[2] in which Swift, an indorsee of a bill of exchange, received the same in payment of a pre-existing debt, without notice of any equities existing between the

same rule is applied to negotiable coupon bonds. Culver *v.* Benedict, 13 Gray, 7; Lehman *v.* Tallahasse etc Co., 64 Ala. 567; Allen *v.* Dallas Ry. Co. 3 Woods, 316, 325.

[1] In Straughan *v.* Fairchild, 80 Ind. 598, the Court say: "On a subject of such general importance, and concerning which there can not properly be a local rule, and in which the commercial world has a common interest, uniformity and certainty of decision is greatly to be desired; and since the highest tribunals in this country and in England are ruling in harmony upon this point, a state court can hardly be justified in adopting, if indeed in adhering to, a different rule."

[2] 16 Peters, 1. (Catron. J. diss.)

drawer and Tyson, the acceptor, arising from want of consideration. In this case, the opinion was delivered by Mr. Justice Story, who, after insisting that the receiving of a negotiable instrument in payment of, *or as security for a pre-existing debt*, is according to the known usual course of trade and business, asked, "And why upon principle should not a pre-existing debt be deemed such a valuable consideration? It is for the benefit and convenience of the commercial world to give as wide an extent as practicable to the credit and circulation of negotiable paper, that it may pass not only as security for new purchases and advances, made upon the transfer thereof, but also in payment of and *as security* for pre-existing debts. The creditor is thereby enabled to realize or to secure his debt, and thus may safely give a prolonged credit, or forbear from taking any legal steps to enforce his rights. The debtor also has the advantage of making his negotiable securities of equivalent value to cash. But establish the opposite conclusion, that negotiable paper can not be applied in payment of or *as security for pre-existing debts*, without letting in all the equities between the original and antecedent parties, and the value and circulation of such securities must be essentially diminished, and the embarrassment of making a sale thereof, often at a ruinous discount, to some third person, and then by circuity to apply the proceeds to the payment of his debts."[1]

[1] In Railroad Co. *v.* Nat. Bank, 102 U. S. 14, 24, the Court (Harlan, J.) say: "The brief dissent of Mr. Justice Catron was solely upon that ground, which renders it quite certain that the whole court was aware of the extent to which the opinion of the court carried the doctrines of the commercial law upon the subject of negotiable instruments transferred or delivered as security for antecedent indebtedness." Mr. Justice Catron says, in his dissentient opinion: "I never heard this question spoken of as belonging to the case, until the principal opinion was presented last evening, and therefore I am not prepared to give any opinion, even if it was called for by the record." Mr. Chief Justice Lawrence, of the Illinois Supreme Court, in Manning *v.* McClure, 36 Ill. 494, referring to the subject says: "The note in the case of Swift *v.* Tyson was taken as payment and not merely as collateral security, and therefore what was said is only dicta; but attention was directed to this by Mr. Justice Ca-

The question was next referred to by the Court in the case of Goodman *v.* Simonds,[1] in which there was a settlement of antecedent indebtedness, the surrender of securities, and making of new notes, payment of the latter being secured by a bill of exchange. There having been a full present consideration for the transfer as collateral security of the bill of exchange, the Court declared the question whether a transfer of negotiable instruments as collateral security for an antecedent debt, without more, would make the pledgee a holder for value in the usual course of business, did not arise.

In McCarty *v.* Roots,[2] the question was squarely presented. The suit was brought against an indorser by a pledgee holding accommodation bill of exchange as collateral security for an antecedent indebtedness, without any other consideration. The Court (McLean, J.) held that the fact that the bills were indorsed as stated did not impair the pledgee's right of recovery, and that such indorsement and delivery of the bills as collateral security for a pre-existing debt was a valid transaction, within the usual course of business.

In a later case, Oates *v.* National Bank,[3] an extension of time in the payment of the antecedent indebtedness was granted, which of itself was sufficient to constitute a pledgee of a negotiable promissory note, properly indorsed, receiving the same before maturity, a holder for value, in the usual course of business. In that case the Court (Harlan, J.) stated that the question "whether the taking of such note merely as collateral security for antecedent debts, without any binding contract for indulgence, would con-

tron, so that the language of Judge Story can not be considered as inadvertently used, and may be regarded as receiving the implied assent of the court, with the exception of Judge Catron." And Judge Story, afterwards, in his work on Promissory Notes, p. 215, n. I, reiterates and supports the doctrine announced in Swift *v.* Tyson.

[1] 20 How. 243.

[2] 21 How. 432.

[3] 100 U. S. 239.

stitute a valuable consideration within the established rules of commercial law, protecting the creditor against defenses or equities between antecedent parties, of which he had no notice, it is not necessary now to decide. That precise question is not presented in this case, and we forbear to express any opinion upon it."

§ 20. Railroad Co. v. National Bank.—The title and interest of a pledgee of negotiable instruments receiving the same as collateral security for an antecedent debt, without more, was finally settled in the Supreme Court of the United States in the leading case, The Franklin City and Newtown Railroad Company *v.* National Bank of the Republic.[1] Negotiable securities, indorsed in blank, entrusted to brokers for negotiation or sale, were misappropriated by them as collateral security for an antecedent debt, without any further consideration. The Court (Harlan, J.) announced the rule, that "the transfer before maturity of negotiable paper, as security for an antecedent debt merely, without other circumstances, if the paper be so indorsed that the holder becomes a party to the instrument, although the transfer is without express agreement by the creditor for indulgence, is not an improper use of such paper, and is as much in the usual course of commercial business as its transfer in the payment of such debt. In either case the bona fide holder is unaffected by equities or defences between prior parties, of which he had no notice."[2] The Court

[1] 102 U. S. 16.

[2] Railroad Co. *v.* National Bank, 102 U. S. 28. Mr. Justice Bradley, in his opinion, while concurring in the judgment, said (p.58): "I do not regard the obligation assumed by the indorsee to present the note for payment and give notice of non-payment as the only, or the principal, consideration of such transfer. The true consideration was the debt due from the indorsers to the indorsee, and the obligation to pay or secure such debt. Had any other collateral security been given, as a mortgage, or a pledge of property, it would have been equally sustained by the consideration referred to, namely, the debt, and the obligation to pay it or to secure its payment. * * Security for the payment of a debt actually owing is a good consideration.

(Harlan, J) say : (p. 24) "The bank did not take the note in suit as a mere agent to receive the amount due when it suited the convenience of the debtor to make payment. It received the note under an obligation imposed by the commercial law, to present it for payment, and give notice of non-payment, in the mode prescribed by the settled rules of that law. We are of opinion that the undertaking of the bank to fix the liabilities of prior parties, by due presentation for payment and due notice in case of non-payment,—an undertaking necessarily implied by becoming a party to the instrument—was a sufficient consideration to protect it against equities existing between the other parties, of which it had no notice. It assumed the duties and responsibilities of a holder for value, and should have the rights and privileges pertaining to that position. The correctness of this rule is apparent in cases like the one now before us. The note in suit was negotiable in form, and was delivered by the maker for the purpose of being negotiated. Had it been regularly discounted by the bank, at any time before maturity, and the proceeds either placed to the credit of the pledgors, or applied directly to the discharge, *pro tanto*, of any one of the call loans previously made to them, it would not be doubted that the bank would be protected against the equities of prior parties. Instead of procuring its formal discount, the pledgors used it to secure the ultimate payment of their own debt to the bank. * * * It was, under the circumstances, the duty of the pledgor to make such payment, or to secure the debt. It was important to them, and was in the usual course of commercial transactions, to furnish such security."

It was urged that nothing having been surrendered by

and sufficient to support a transfer of property. When it is a promissory note or bill of exchange, it has the effect of giving absolute title and of cutting off prior equities, provided the ordinary conditions exist to give it that effect. If not transferred before maturity or in due course of business, then, of course, it can not have that effect. A transfer for the purpose of securing a debt is a transfer in due course."

the pledgee, to permit antecedent equities to prevail would deprive him of no right or advantage enjoyed at the time of the transfer, or impose upon him additional burdens or inconveniences. The Court, commenting upon these suggestions, said: "This *may be true in some*, but it is not true in most cases; nor, in our opinion, is it ever true when the note, upon its delivery to the transferee, is in such form as to make him a party to the instrument and impose upon him the duties which, according to the commercial law, must be discharged by the holder of negotiable paper, in order to fix liability upon the indorser."[1]

§ 21. The State Rule in such Cases of Pledge not Followed.—Attempts have been made to secure from the Federal Court of last resort an acknowledgment of the views of the several State Courts in construing the rights of holder of negotiable instruments as collateral security for antecedent debt, without further consideration, as furnishing the proper guide in cases appealed from those States. The United States Supreme Court has declined, in relation to questions of commercial law, to consider itself bound by the decisions of the State Appellate Courts.[2] In a recent case, where a debtor had given to a national bank a negotiable note as collateral security for a pre-existing debt, paying usurious interest for an extension of the time of payment, it was insisted that the rule as applied by the Alabama Courts, which do not follow Swift *v.* Tyson on the question, should be applied. The Supreme Court held otherwise,[3] and again in a later case.[4]

§ 22. The Rule in England and Canada.—In England, the rule is approved that the holder of negotiable

[1] Railroad Co. *v.* National Bank, p. 27.

[2] Swift *v.* Tyson, 16 Pet. 1, 18; Carpenter *v.* Ins. Co. Ib. 195; Ames *v.* Smith, Ib. 303, 314; Watson *v.* Turpley, 18 How. 517; Goodman *v.* Simonds, 20 Ib. 343, 371.

[3] Oates *v.* Nat. Bank, 100 U. S. 239.

[4] Railroad Co. *v.* Nat. Bank, 103 U. S. 14, 31.

promissory notes or bills of exchange, receiving the same properly indorsed, before maturity, as collateral security for an antecedent debt, without more, in good faith, without notice of prior equities, is a holder for value, in the usual course of business, free from all antecedent equities as the most favored holder of negotiable paper.[1] The like rule is also approved in the Dominion of Canada.[2] The English House of Lords has applied the rule to checks drawn upon upon a bank, as being equally applicable to checks and such negotiable instruments as were payable on demand as to those payable at a future time.[3] Receiving such negotiable paper charged with the duty of presentment and to give notice of non-payment, if necessary, upon default, the pledgee is charged with the amount of such securities where loss is caused by his neglect.[4] And where a creditor takes a note or bill payable at a future day, either in payment of or as collateral security for a pre-existing debt, he can not commence an action at law for his original debt, un-

[1] Currie *v.* Misa, L. R. 10 Ex. 153, 165; s. c. affirmed on appeal, L. R. 1 App. Cas. 554; Percival *v.* Frampton, 2 C. M. & R. 180; Poirier *v.* Morris. 2 El. & Bl. 89; Collins *v.* Martin, 1 P. & B. 650; Heywood *v.* Watson, 4 Bing. 496; s. c. 1 M. & P. 268; Bramah *v.* Roberts, 1 Bing. N. C. 469; Crofts *v.* Beale, 11 C. B. N. S. 172; Bosanquet *v.* Forster, 9 C. & P. 659; Whistler *v.* Foster, 14 C. B. N. S. 248; Leask *v.* Scott, L. R. 2 Q. B. D. 376; Gorgier *v.* Mieville, 3 B. & C. 45; In re Patent File Co. L. R. 6 Ch. 83. In Railroad Company *v.* Nat. Bank, 102 U. S. 14, 48, Mr. Justice Bradley, after reviewing the English authorities already cited, says: "These authorities are sufficient to show that there is but one voice upon the subject in the parent country, and that they speak to the point with a degree of unanimity and uniformity well calculated to excite admiration and to inspire confidence that the rule of decision is both correct and just. Not only every court, but every judge of every court, in that country, concurs in the proposition that the holder of such a negotiable security before maturity, as collateral to a pre existing debt, without notice of any prior equities, is a bona fide holder for value in the usual course of business and that his title to the instrument is good, and wholly unaffected by any such prior equities between the antecedent parties."

[2] Bank *v.* Chamber, 11 Rich. 657.

[3] Currie *v.* Misa, supra.

[4] Peacock *v.* Purcell, 14 C. B. N. S. 728; Heywood *v.* Watson, 1 M. & P. 268; s. c. 4 Bing. 496.

til such note or bill becomes payable, and default is made;[1] nor where the collateral note or bill, indorsed to the pledgee, has been transferred while current, and passed into the hands of third persons for value, and is still outstanding.[2]

The English Courts have discussed in relation to the transfer of negotiable instruments as collateral security for antecedent debts, whether the requisite valuable consideration to constitute the pledgee a holder for value, should be presumed to arise from the implied agreement of the creditor to suspend his remedies for the period during which the note or bill so pledged has to run until maturity;[3] or from the fact that a negotiable security given for such a purpose is a conditional payment of the debt, the condition being that the debt survives if the security is not realized.[4] The latter view is approved in the leading case of Currie *v.* Misa,[5] in which the court accepted as correct the following definition of consideration: "A valuable consideration, in the sense of the law, may consist either in some right, interest, profit, or benefit accruing to the one party, or some forbearance, detriment, loss, or responsibility, given, suffered, or undertaken by the other."[6]

§23. The Contra Rule—The Pledgee for an Antecedent Debt, Without More, not a Holder for Value.—The rule prevails in certain states that the pledgee, receiving negotiable instruments, before maturity, as collateral security for an antecedent debt, without more, although becoming a party thereto, and without notice of equities, is not a holder for value, in the usual course of business, but takes only the title of the pledgor, subject to

[1] Stedman *v.* Gooch, 1 Esp. 4; Price *v.* Price, 16 M. & W. 232, 243.

[2] Price *v.* Price, supra.

[3] Alliance Bank *v.* Broom, 2 Drew & S. 289; Morton *v.* Burn, 7 Ad. & E. 19; Baker *v.* Walker, 14 M. & W. 465; Purcell *v.* Peacock, supra.

[4] Belshaw *v.* Bush, 11 C. B. 191; Griffiths *v.* Owens, 13 M. & W. 58, 64.

[5] L. R. 10 Ex. 153; s. c. 1 App. Cas. 554.

[6] Com. Dig. Action on the Case. assumpsit, B. 1, 15.

all antecedent equities existing at the time of the transfer. This rule prevails, with various but not essential modifications, in the States of Alabama, Arkansas, Iowa, Kentucky, Maine, Mississippi, Missouri, Nevada, New Hampshire, New York, North Carolina, Ohio, Pennsylvania, Tennessee, Vermont and Wisconsin.[1] It is supported mainly upon the

[1] Bertrand *v.* Barkman, 13 Ark. 150; McKenzie *v.* Bank, 28 Ala. 606; Boyd *v.* Beck, 29 Ib. 703; Fenouille *v.* Hamilton, 35 Ala. 319; Cullum *v.* Branch Bank, 4 Ib. 21; Andrews *v.* McCoy, 8 Ib. 920; Wagner *v.* Simmons, 61 Ib. 143; Bank of Mobile *v.* Polnitz, 61 Ala. 147; Iowa College *v.* Hill, 12 Ia. 462; Ryan *v.* Chew, 13 Ib. 389; Union Nat. Bank *v.* Barber, 56 Ia. 559; Lee *v.* Smead, 1 Metc. 628; Alexander *v.* Springfield Bank, 2 Ib. 534; Greenwell *v.* Hayden, 78 Ky. 332; Smith *v.* Hiscock, 14 Me. 149; Nutler *v.* Stover, 48 Ib. 163; Bramhall *v.* Beckett, 31 Ib. 205; Homes *v.* Smith, 16 Ib. 177; Brooks *v.* Whitson, 7 S. & M. (Miss.) 513; Goodman *v.* Simonds, 19 Mo. 106; Grant *v.* Kidwell, 30 Ib. 455; Logan *v.* Smith, 62 Ib. 455; Ferry *v.* Hickman, 1 Mo. App. 119; Brainard *v.* Reavis, 2 Ib. 490; Jenness *v.* Bean, 10 N. H. 266; Williams *v.* Little, 11 Ib. 66; Fletcher *v.* Case, 16 N. H. 68; Rice *v.* Railt. 17 N. H. 116; Fair *v.* Howard, 6 Nev. 304; Bay *v.* Coddington, 5 Johns. 54; s. c. 20 Johns. 637; Clark *v.* Ely, 2 Sandf. Ch. 166; Fenby *v.* Pritchard, 2 Ib. 151; Younges *v.* Lee, 18 Barb. 187; Prentice *v.* Graves, 33 Ib. 621; American Ex. Bank *v* Corliss, 46 Ib. 19; Bright *v.* Judson, 47 Ib. 29; Stalker *v.* McDonald, 6 Hill 93; Wardell *v.* Howard, 9 Wend. 170; Rosa *v.* Brotherson, 10 Ib. 85; Ontario Bank *v.* Worthington, 12 Ib. 593; Payne *v.* Cutler, 13 Ib. 605; Lawrence *v.* Clark, 36 N. Y. 128; Turner *v.* Treadway, 53 Ib. 650; Taft *v.* Chapman, 55 Ib. 445; Phoenix Ins. Co. *v.* Church, 81 Ib. 222; Duncomb *v.* Railroad Co., 84 Ib. 190, 204; s. c. 88 Ib. 1; Roxborough *v.* Messick, 6 Ohio St. 448; Cleveland *v.* State Bank, 19 Ib. 145; Copeland *v.* Manton, 22 Ib. 398, 402; Kingsland *v.* Pryor, 33 Ib. 19; Bank *v.* Fowler, 36 Ib. 524; Pitts *v.* Foglesong, 37 Ib. 676; Bank *v.* Bank, Ib. 208; Hartman *v.* Duval, 1 Rawle, 219; Petrie *v* Clark, 11 S. & R. 377; Depeau *v.* Washington, 6 Whart. 279; Trotter *v.* Shippen, 2 Pa. St. 258; Appleton *v.* Donaldson, 3 Ib. 381; Kirkpatrick *v* Muirhead, 16 Ib. 117; Lord *v.* Ocean Bank, 20 Ib. 384; Sitgreaves *v.* Bank, 49 Ib 359; Lenheim *v.* Wilmarding 55 Ib. 73; Ashton's App. 73 Ib. 153; Pratt's App., 77 Ib. 378; Royer *v.* Keystone Bank, 83 Ib. 248; Cummings *v.* Boyd, Ib. 372; Penn Bank *v.* Frankish, 91 Ib. 344; Dovey's App., 97 Ib. 53; Maynard *v.* Bank, 98 Ib. 250; King *v.* Doolittle, 1 Head (Tenn) 77; Kimbro *v.* Lytle, 10 Yerg. 417, 428; Napier *v.* Elam, 6 Ib. 108; Richardson *v.* Rice, 9 Baxt. 290; Nichols *v.* Bate, 10 Yerg. 429; Raddick *v.* Jones, 6 Ib. 109; Atkinson *v.* Brooks, 26 Vt. 569; Austin *v.* Curtis, 31 Vt. 64; Cook *v.* Helms, 5 Wis. 111; Stevens *v.* Campbell, 13 Ib. 375; Jenkins *v.* Schwab, 14 Ib. 1; Schufeldt *v.* Pease, 16 Ib.

ground that a valuable present consideration must be given by a pledgee to constitute him a holder for value in the usual course of business; and that a pledgee of negotiable instruments as collateral security, who has made no present advances, nor satisfied any existing debt, nor released any securities, nor incurred any new responsibilities on the credit of the paper, and who receives the same simply as collateral security for an antecedent debt, without further consideration, is not a holder for value, in the usual course of business, and protected from antecedent equities.

The rule, as stated, has become a part of the settled commercial law of the several states named, and is not likely to be changed except by statutory enactment. The controlling objections to it are that it serves to embarrass and check the free use of commercial paper by parties dealing bona fide; forces the debtor to sell his negotiable securities often at a sacrifice, in order to apply the proceeds to the payment of an antecedent debt, where he might, by using the same as collateral security, obtain a moral claim at least for time to pay such debt, and probably would be able to pay it without sacrifice; and introduces an element of litigation in many transactions which never appears in states and countries where the other and better rule prevails.

§24. The New York Rule as to Pledge for Antecedent Debt.—The leading case in New York, Coddington *v.* Bay,[1] was decided by the Court of Errors, and involved

660; Bange *v.* Flint, 25 Ib. 544; Bowman *v.* Vankuren, 29 Ib. 209; Knox *v.* Clifford, 38 Ib. 656; Body *v.* Jewson, 33 Wis. 402, 410.

[1] 5 Johns. 54; s. c. Johns. 637. Subsequently to writing the opinion in this case, Chancellor Kent added to his Commentaries, vol. 3, p. 81, n. b., the significant note: "Mr. Justice Story, in his treatise on Promissory Notes, p. 215, n. 1, repeats and sustains the decision in Swift *v.* Tyson, 16 Pet. 15, 22, and I am inclined to concur in that decision as the plainer and better doctrine." Referring to this, Mr. Justice Harlan, in delivering the opinion of the United States Supreme Court, in Railroad Company *v.* National Bank, 102 U. S. 14, remarks, (p. 25): "Of course it did not escape Chancellor Kent's attention that the Court in

a wrongful misappropriation of negotiable instruments as collateral security for responsibility theretofore incurred as indorser for the pledgor, with no other consideration. The pledgor was insolvent at the time. The pledgee, having made no advance, incurred no responsibility upon account of the paper, nor satisfied an existing debt, nor paid money or property, nor created a debt, was not a holder for value, in the due course of business, and the collateral notes, or their proceeds, with interest, were decreed to be returned to the owner. In a later case[1] heard after the decision of the decision of the United States Supreme Court in Swift *v.* Tyson,[2] the rule announced was affirmed in another case of misappropriation of negotiable instruments by one holding full title, the court reiterating that a pledgee of negotiable instruments, as collateral security for an antecedent debt, who had neither parted with value, nor relinquished securities previously held, was not a holder for value, in the usual course of business; and the rule was applied in another case, even where the paper had been received in payment of an antecedent debt.[3] The decisions of the New York courts, from the leading position they have taken on this subject, have been much discussed.[4] The courts of

Swift *v.* Tyson declared the equities of prior parties to be shut out as well when the note was merely pledged as collateral security for a pre-existing debt as when transferred in payment of or extinguishment of such debt."

[1] Stalker *v.* McDonald, 6 Hill 93 (Walworth, Chancellor.)

[2] 16 Pet. 1.

[3] Francia *v.* Joseph, 3 Edw. Ch. 182; Ward *v.* Howard 88 N. Y. 74.

[4] In Blanchard *v.* Stevens, 3 Cush. 162, 168, the court (Dewey, J.) say: "All the cases of the New York courts concur in this: that if the party receiving the note parts with anything valuable, he is entitled to enforce the payment of the note irrespective of the equities as between the original parties. But may you not as well show a legal consideration by showing forbearance to act as by showing an act done? A damage to the promisee is all that is necessary to show a good consideration for a promise; and ought not the same rule to apply in protection of a note transferred to him? If the party did not receive the note as collateral security, he might have pursued other remedies to enforce the security or payment of the debt. He might have obtained other securities, or perhaps payment in money. * * The convenience

New York have steadily adhered to the rulings in the early case of Coddington *v.* Bay.[1]

§ 25. The Rule in Missouri.—In Missouri, an early decision declared the rule as announced in Swift *v.* Tyson,[2] but later, a pledgee receiving negotiable instruments as collateral security for an antecedent debt, without more, was declared subject to all antecedent equities existing between the original parties.[3] The decision was reversed in the United States Supreme Court.[4] The Supreme Court of Missouri refused to follow the United States Supreme Court, and the rule as stated has been followed in later cases.[5] The equities to which the holder of such paper as collateral security for a pre-existing debt are subject are confined, however, to those existing between the orignal parties; nor can they be asserted against such holder by a creditor of the maker of the note seeking to attach the same.[6] The rule that where the payee of a negotiable

and safety of those dealing in negotiable paper seems to require and justify the rule that when a person takes a negotiable note, not overdue, or apparently dishonored, and without notice, actual or constructive, of a want of consideration, or other defense thereto, whether in payment of a precedent debt, or as collateral security for a debt, the holder should have the legal right to enforce the same against the parties thereto, notwithstanding such defenses might have been effectual as between the original parties." Lord Coleridge, C. J, referring to the case of Coddington *v.* Bay, supra, after citing Chancellor Kent, says in his dissentient opinion, in Currie *v.* Misa, L. R. 10 Ex. 153: "It is the credit given to the paper, and the consideration bona fide paid on receiving it, that entitles the holder, on grounds of commercial policy, to such extraordinary protection, even in cases of the most palpable fraud. It is an exception to the general rule of law, and ought not to be carried beyond the necessity that created it." Similar language is used in Whistler *v.* Forster, 14 C. B., N. S, 248.

[1] See §23, note 1.

[2] Clark *v.* Loker, 11 Mo. 97.

[3] Goodman *v.* Simonds, 19 Mo. 106.

[4] Simonds *v.* Goodman, 20 How. 343.

[5] Grant *v.* Kidwell, 30 Mo. 490; Savings Inst. *v.* Holland, 38 Ib. 49; Logan *v.* Smith, 62 Ib. 458; Davis *v.* Carson, 69 Ib. 609; Terry *v.* Hickman, 1 Mo. App. 119; Brainerd *v.* Reaves, 2 Ib. 490.

[6] Davis *v.* Carson, supra.

promissory note indorses the same before maturity, a payment made to him before his indorsement will not extinguish the debt so far as the indorsee is concerned, unless the latter had notice at the time of the indorsement, is also applied in cases of the transfer of such notes as collateral security for antecedent liability.[1]

§ 26. THE RULE IN OHIO AND OTHER STATES.—The question was elaborately considered by the Supreme Court of Ohio in the leading case of Roxborough *v.* Messick,[2] and the following propositions approved: First, where the note of a third person is transferred before due as collateral security, and for value, such as in consideration of a loan or advancement, or a stipulation, express or implied, of further time to pay a pre-existing debt, or the like, the holder of such collateral will be protected from infirmities affecting the instrument before it was thus transferred; and, Second, when a debt is created, without any stipulation for further security, and the debtor, without any application to do so, voluntarily transfers a negotiable instrument to secure the pre-existing debt, and both parties are left in respect to the pre-existing debt in *statu quo*, no new consideration, stipulation for delay, or credit being given or right parted with by the creditor, he is not a holder of the collateral for value, in the usual course of trade, and receives it subject to all the equities existing against it at the time of the transfer. These rules have been consistently followed in the later cases.[3]

In Alabama, the indorsee of commercial paper, acquiring it either before or after maturity, merely as collateral security for a pre-existing debt, receives the same subject to all the defenses which the maker could prefer against the

[1] Grant *v.* Kidwell, supra.

[2] 6 Ohio St. 448; s. c. 11 Ib. 172.

[3] Hatch *v.* Langdon, 7 Ohio St. 245; Gebhart *v.* Sorrels, 9 Ib. 461; Cleveland *v.* State Bank, 19 Ib. 145; Kingsland *v.* Prior, 33 Ib. 19; Bank *v.* Fowler, 36 Ib 524; Copeland *v.* Manton, 22 Ib. 398; Pitts *v.* Foglesong, 37 Ib. 676; Bank *v.* Bank, Ib. 208.

payee if he had remained the holder. This right exists as to matters of set-off or discount as well as to defenses affecting the instrument itself; and one of two joint debtors was allowed to set-off a debt due to him alone from the common creditor.[1] But the rule was limited in Lehman *v.* Tallahassee Manufacturing Company[2] declaring that a corporation having authority to issue its negotiable bonds for proper corporate purposes, such bonds might be used as collateral security for antecedent debts. "It would unnecessarily interfere with the operations of the company (say the court) to declare that these bonds can be employed in paying antecedent debts, but must not be hypothecated as security for such debts, although by such hypothecation forbearance can be obtained, and the debts paid eventually without an absolute unconditional transfer of the bonds."

Defining a holder for value of commercial paper, the Supreme Court of Arkansas held that he must have either given money or property in exchange for the note, or having received it absolutely or unconditionally in payment of a pre-existing debt, or relinquished some valuable security or some valuable right on the sole strength of the identical paper so innocently received in the due course of trade, and that when a note is transferred only by way of indemnity against probable future loss, or from an existing liability, or as a collateral security for a pre-existing debt, it is not such a holding as comes within the rule.[3]

The decisions in Vermont are conflicting. In the first case[4] the opinion was delivered by Judge Redfield, the

[1] Bank of Mobile *v.* Poelnitz, 61 Ala. 147; Thurman *v.* Stoddard, 63 Ib. 333; Connerly *v.* Planters' Ins. Co. 66 Ib. 432.

[2] 64 Ala. 567.

[3] Bertrand *v.* Barkham, 13 Ark. 150.

[4] Atkinson *v.* Brooks, 26 Vt. 569, 576. Redfield (C. J.) said: "One whose debt is due must pay it, or become a bankrupt in a commercial sense. If, instead of money he gives a bill or note, either on time or sight, whether this is payment in form or is given as collateral to his debt, he gains time, and is saved from the disgrace and ruin of stopping payment. Viewed as it may be, the

court adopting the view that the indorsee of a bill of exchange as collateral security for a pre-existing debt, was prima facie a holder for value, and was entitled to recover against an accommodation indorser, not known to him to be such when the bill was taken. In a subsequent case[1] the rule was applied in favor of a surety on a letter of credit, who was discharged where, without his consent, after the maturity of the paper for the payment of which he was bound, the holder received as collateral security for its payment, another obligation with other sureties, payable at a future time. In a later case[2] the court (Judge Redfield dissenting, but filing no opinion) overruled the previous decisions, so far as they conflicted with its then ruling, that no binding agreement to delay the collection of an overdue debt could be implied from the receipt by the creditor from the principal debtor of a note or other obligation not yet due, merely as collateral security therefor, and therefore the pledgee thereof is not a holder for value, in the usual course of business.

§ 27. The Pledgee for Antecedent Debt, with New Consideration, a Holder for Value. — The pledgee of negotiable instruments, receiving the same before maturity, indorsed where required, so as to become a party thereto, as collateral security for the payment of an antecedent debt, who, by some affirmative act or contract in

debtor in either case derives the benefit of an implied understanding that the creditor will not immediately press for payment, unless the new security proves unproductive, and, if it does, that the creditor may pursue any other remedy."

[1] Michigan State Bank *v.* Leavenworth, 28 Vt. 209.

[2] Austin *v.* Curtis, 31 Vt. 64. The Court say: "By taking such an obligation [an indorsed negotiable note] as collateral security merely, the creditor doubtless furnishes ground for an expected indulgence on the original debt. But the debtor is bound to treat this as at all times countermandable at the will of the creditor." Judge Redfield again stated his views, after the decision in Austin *v.* Curtis, in a note to the case of Le Breton *v.* Pierce (2 Allen, 8) 1 Am. L. R., N. S. 35.

relation to such antecedent debt, gives a new and valuable consideration for the transfer thereof, is regarded in every jurisdiction as a holder for value in the usual course of business. The pledgee, who thus receives negotiable collateral securities for an antecedent debt, is as much favored, under the general commercial law of every state, as the pledgee who receives such securities upon a present advance. He is entitled to enforce the payment of such collateral bills or notes or bonds, as against parties bound thereon, and the pledgor, where he is an indorser thereof, free from antecedent equities. A valid extension of time upon the principal note for a definite period of time, being an agreement to forbear suit upon the original indebtedness, is frequently of the utmost importance to the debtor, and constitutes one of the oldest titles of the law under the head of forbearance.[1] The relinquishment by the creditor of some security of equal value,[2]

[1] Swift *v.* Tyson, 16 Pet. 1; Goodman *v.* Simonds, 20 How. 343, 371, Oates *v.* Nat. Bank, 100 U. S. 239; Depeau *v.* Waddington, 6 Whart 219; Petrie *v.* Clark, 11 S. & R. 377; Jennison *v.* Stafford, 1 Cush. 168; Wheeler *v.* Slocum, 16 Pick. 52; Elting *v.* Vanderlyn. 4 Johns. 273; Bank *v.* Wexson, 42 N. Y. 438; Erwin *v.* Shaffer, 9 Ohio St. 43; Roxborough *v.* Messick, 6 Ib. 448; Holzworth *v.* Koch, 26 Ib. 33; First Nat. Bank *v.* Fowler, 36 Ib. 524; Kingsland *v.* Pryor, 33 Ib. 19; Paulette *v.* Brown, 40 Mo. 54; Worcester Nat. Bank *v.* Cheeney, 87 Ill. 602, 608; Ryan *v.* Chew, 13 Ia. 589; International Bank *v.* Barber, 56 Ib. 559; Austin *v.* Curtis, 31 Vt. 64; Atkinson *v.* Brooks, 26 Vt. 374; Morton *v.* Burn, 7 A. & E. 19; Baker *v.* Walker, 14 M. & W. 465; Walton *v.* Mascall, 13 M. & W. 453.

[2] Bertrand *v.* Barkman, 13 Ark. 150; Payne *v.* Benseley, 8 Cal. 260; Goodman *v.* Simonds, 20 How. 343, 371; Bank of Salina *v.* Babcock, 21 Wend. 299; Young *v.* Lee, 2 Kern. 551; Bank *v.* Vanderhorst, 32 N. Y. 523; Lawrence *v.* Clark, 36 Ib. 128; Pratt *v.* Cowan, 37 Ib. 440; Chrysler *v.* Renois, 43 Ib. 209; Robbins *v.* Richardson, 2 Bosw. 248; Phœnix Ins. Co. *v.* Church, 81 N. Y. 222; Goodwin *v.* Conklin, 85 N. Y. 21; First Nat. Bank *v.* Bentley, 21 Minn. 87; Depeau *v.* Waddington, 6 Whart. 220. Notwithstanding such paper was used against the restriction of the accommodation maker, where the pledgee was without knowledge or notice of the facts. Kingsland *v.* Pryor, 33 Ohio St. 19. Hornblower *v.* Proud, 2 B. & A. 327; Rideout *v.* Bristow, 1 Cromp & J. 231. Nor is the pledgee regarded as a holder for value, where subsequently to the pledge of the collateral paper for an antecedent debt the creditor grants indulgence or forbears to enforce his

or the giving of a new consideration,[1] or discontinuing legal process against the debtor,[2] or where, under statutory provisions, the acceptance of such collateral security, payable at a future time, is a waiver of the right of attachment of the property of the debtor upon the original indebtedness,[3] are valuable considerations to bring the pledgee of negotiable collateral securities within the rule, as stated.

§ 28. Transfer in Payment of Antecedent Debt. —A pre-existing debt or obligation constitutes a valuable consideration, and one who takes a bill or note of a third party in absolute payment of such obligation, is a holder for value and unaffected with equities between the antecedent parties of which he had no notice,[4] even although it is

remedies for the collection of his debt, when it is not shown that such indulgence or forbearance was an element of the contract by which he acquired the same. Fenouille *v.* Hamilton, 35 Ala. 319.

[1] King *v.* Doolittle, 1 Head, 77; Varnum *v.* Bellamy, 4 McLean, 87; White *v.* Springfield Bank, 3 Sandf. 222; New York etc. Works *v.* Smith, 4 Duer, 362.

[2] Boyd *v.* Cummings, 17 N. Y. 101.

[3] Payne *v.* Bensley, 8 Cal. 260. The relation of the parties not being the same after the giving of the collateral security as before, although no extension of time was given on the original note, and no new consideration except as stated. Naglee *v.* Lyman, 14 Cal. 455.

[4] Bank *v.* Hall, 6 Ala. 639; Pond *v.* Lockwood, 8 Ib. 669; Barney *v.* Earle, 13 Ib. 106; Brush *v.* Scribner, 11 Conn. 288; Adams *v.* Smith, 35 Me. 324; Holmes *v.* Smith, 16 Me. 177; Cecil Bank *v.* Heald, 25 Md. 563; Norton *v.* Waite, 20 Me. 175; Emanuel *v.* White, 34 Miss. 56; Bostwick *v.* Dodge, 1 Mich. 413; Outhwite *v.* Peters, 13 Ib. 539; Stevenson *v.* Hyland, 11 Minn. 198; Russell *v.* Haddock, 3 Gilm. 235; Manning *v.* McClure, 35 Ill. 490; Mix *v.* Nat. Bank, 91 Ill. 20; McKnight *v.* Knisely, 25 Ind. 336; Kirkpatrick *v.* Muirhead, 16 Pa. St. 123; Rosenberg *v.* Bitting, 15 Ib. 278; Bardsley *v.* Delp, 88 Ib. 420; Penn. Bank *v.* Frankish, 91 Ib. 344; Draper *v.* Cowles, 27 Kans. 484; McCoy *v.* Hazlitt, 14 Kan. 430; Medberry *v.* Soper, 17 Ib. 369; Wheeler *v.* Fanrot, 37 Ohio St. 26; Green *v.* Kennedy, 11 Mo. App. 497; Green *v.* Kennedy, 6 Ib. 577; Reddick *v.* Jones, 6 Ired. (N. C.) 109; Young *v.* Hobbs, 5 Nev. 433; Williams *v.* Little, 11 N H. 66; Brown *v.* Leavitt, 31 N. Y. 113; Carlisle *v.* Wishart, 11 Ohio, 172; Bank *v.* Carrington, 5 R. I. 515; King *v.* Doolittle, 1 Head. 77; Dixon *v.* Dixon, 31 Vt. 450; Quinn *v.* Hard, 43 Vt. 375; Lee *v.* Kimball, 45 Ib. 172; Bank *v.* Scoville, 24 Wend. 115; Bank *v.* Gilli-

taken for less than its face value,[1] unless the discount is so great as to be of itself evidence of mala fides.[2] Where such pre-existing debt is represented by a note or other evidence of indebtedness, the receipt of the new note in absolute payment extinguishes the liability upon the old note; and this rule has been applied for the benefit of stockholders of a corporation whose individual liability for debts was sought to be enforced on the ground that they were stockholders at the time of the creation of the debt for which the old note was given.[3]

§ 29. Such Transfer is Prima Facie as Collateral Security.—Under the general law commercial, in this country and England, the negotiation of a bill or note of a third party for an antecedent debt, does not operate as a discharge of such debt, unless such note is accepted as in absolute payment. Prima facie, it is considered as a conditional payment or as collateral security, although by express agreement it may be a satisfaction or bar of the original demand.[4] Nothing short of an actual agreement or of evi-

land, 23 Ib. 311; N. Y. Marbled Iron Works *v.* Smith, 4 Duer, 377; Gould *v.* Segee, 5 Ib. 260; Bank *v.* Babcock, 21 Wend. 499; Phœnix Ins. Co. *v.* Church, 81 N. Y. 226; Chrysler *v.* Renois, 43 Ib. 209; Ward *v.* Howard, 88 Ib. 74; Stevens *v.* Campbell, 13 Wis. 376; Heath *v.* Silverthorne etc. Co, 39 Ib. 146; Knox *v.* Clifford, 35 Ib. 651; Bange *v.* Flint, 25 Ib. 544; Swift *v.* Tyson, 16 Pet. 1; Sawyer *v.* Prickett, 19 Wall. 147.

[1] Bange *v.* Flint, 25 Wis. 544.

[2] Heath *v.* Silverthorne, etc. Co., 39 Wis. 146.

[3] Wheeler *v* Faurot, 37 Ohio St. 26; Castleman *v.* Holmes, 4 J. J. Marsh, 1; Milliken *v.* Whitehouse, 49 Me. 527; Fisher *v.* Marvin, 47 Barb. 159; Parrott *v.* Colby, 6 Hun, 55.

[4] The Kimball, 3 Wall. 37; Day *v.* Thompson 69 Ala. (11 Rep. 391); Myatt *v.* Bell, 41 Ala. 222; Albright *v.* Griffin, 78 Ind. 182; Shephard *v.* Allen, 16 Kan. 184; Cooper *v.* Enden, 15 Ib 572; Comstock *v.* Smith, 23 Me. 202; Fowler *v.* Ludwig, 34 Ib. 455; Partee *v.* Bedford, 51 Miss. 84; Young *v.* Hibbs, 5 Nev. 433; McLean *v.* Walker, 10 Johns. 471; Muidon *v.* Whitlock, 1 Cow. 290; Com. Exch. Ins. Co. *v.* Babcock, 57 Barb. 231; Hunter *v.* Moul, 98 Pa. St. 13; Leas *v.* James, 10 S. & R. 307; Wallace *v.* Forcman, 4 Watts, 380; Stone *v.* Miller, 16 Pa. St. 450; McIntyre *v.* Kennedy, 29 Ib. 448; Brown *v.* Scott, 51 Ib. 357; League *v.* Waring, 85 Ib.

dence from which a positive inference can be drawn, will make such transaction a discharge of the debtor upon the first claim.[1] The actual intention of the parties will govern. Evidence is admitted to show that the negotiation of such paper was as collateral security and not as payment.[2] The burden of showing that the receipt by the creditor of a note of a third person constituted an absolute payment of an antecedent debt, is upon the party so alleging.[3] And if such paper, properly indorsed, is shown to have been negotiated as conditional payment, and by the gross neglect of the creditor holding the same to apply in time to the maker thereof, the amount of the note is lost, the antecedent debt is extinguished.[4]

244; Schaub *v.* Arrowsmith, 9 N. J. Eq. 323; Freeholders *v.* Thomas, 20 Ib. 41; Hutchinson *v.* Swartsweller, 32 Ib. 205; Wildrich *v.* Swain, 34 Ib. 167; Swain *v.* Frazier, 35 Ib. 326 (14 Rep. 277); Morris *v.* Harveys, 75 Va. 726 (13 Rep. 480); Butts *v.* Dean, 2 Met. 76; Parham Machine Co. *v.* Brock, 113 Mass. 195; Dows *v.* Swett, 134 Mass. 140 (15 Rep. 466); Valpy *v.* Oakley, 16 Q. B. 949; Miles *v.* Gorton, 2 Cr. & M. 512; Sibree *v.* Tripp, 15 M. & W. 23; Belshaw *v.* Bush, 11 C. B. 206. In Day *v.* Thompson, supra, there was an express agreement by the creditor to take a N. Y. draft "in payment of bill in full." The bank failed before presentment, but the effect of the receipt of the draft as payment was not avoided thereby. Lowry *v.* Murrell, 2 Port. 280; Carriere *v.* Ticknor, 26 Ala. 571; Fulford *v.* Johnson, 15 Ib. 385. The receipt of a non-negotiable note will in no sense operate as a payment of the antecedent indebtedness, unless such is the express intention of the parties. Bristol Co. *v.* Probasco, 64 Ind. 406; Stout *v.* Stout, 77 Ind. 541.

[1] McIntyre *v.* Kennedy, 29 Pa. St. 448.

[2] McLean *v.* Walker, 10 Johns. 471; Comstock *v.* Smith, 23 Me. 202; Partee *v.* Bedford, 51 Miss. 84; Stone *v.* Miller, 16 Pa. St. 450; Sykes *v.* Gerber, 98 Ib. 179; Butts *v.* Dean, 2 Met. 76; Parham Machine Co. *v.* Brock, 113 Mass. 195; Dows *v.* Swett, supra.

[3] In re Parker, 11 Fed Rep. 397.

[4] Gallagher's Exec. *v* Roberts, 2 Wash. 191. As where a person receives a promissory note drawn to his own order for a debt due to him, and gives a receipt wherein he states that he has settled and received payment in full by taking the note, and subsequently brings suit upon such note and judgment is given for the defendant. Such judgment is a bar to any subsequent action upon the original demand, the subject of both suits being in fact the same. Sykes *v.* Gerber, 98 Pa. St. 179.

§ 30. The Rule in Massachusetts and Vermont. —The rule in Massachusetts is, that where a debtor gives his own negotiable promissory note to his creditor for the amount of a pre-existing simple contract debt, it is prima facie a payment or satisfaction of the debt.[1] If such note be given for an amount due on an execution, and the execution be discharged, it is prima facie evidence of payment.[2] This presumption is founded upon the consideration that when a note is given for goods, it is equally convenient for the creditor to sue on the note as on the original consideration, and no reason exists for any further vitality of the original claim.[3] The presumption is one of fact, and not of law, and may be rebutted,[4] and does not apply to non-negotiable paper,[5] nor does it exist where the creditor, upon taking such new note, retains the obligations of third parties held by him,[6] nor upon receiving a new note and mortgage where the note surrendered was secured by mortgage also.[7] But if such new note and mortgage is taken for an old note unsecured, which is surrendered, it is presumed to be payment.[8] Where such new note is taken for a pre-existing debt, secured by mortgage, it is only presumptive evidence of payment, and a question of fact for the jury.[9] Checks of a third party dishonored, and not paid, are not payment.[10]

Under the decisions of the Supreme Court of Vermont, a promissory note, either of the debtor or of a third person, given in settlement of an account, or for a pre-existing debt, is prima facie payment.[11] Such presumption may be

[1] Dodge *v.* Emerson, 131 Mass. 467; Thacher *v.* Dunsmore, 5 Ib. 299.

[2] Day *v.* Hickney, 14 Allen, 255.

[3] Curtis *v.* Hubbard, 9 Met. 322.

[4] Medledge *v.* Boston Iron Company, 5 Cush. 170.

[5] Howland *v* Coffin, 9 Pick. 54.

[6] Butts *v.* Dean, 2 Met. 76; Appleton *v.* Parker, 15 Ib. 173.

[7] Taft *v.* Boyd, 13 Allen, 84.

[8] Adams *v.* Jenkins, 16 Gray, 146.

[9] Dodge *v.* Emerson, 131 Mass. 467.

[10] Small *v.* Franklin Ins. Co. 99 Mass. 277.

[11] Hutchins *v.* Olcott, 4 Vt. 549; Torrey *v.* Baxter, 13 Ib. 452; Farr *v.* Stevens, 26 Ib. 299; Collamer *v.* Langdon, 29 Ib. 32; Wait *v.* Brewster, 31 Ib. 516.

rebutted by evidence that the note was not received as payment, the question whether it was so received being one of fact, depending upon the contract or understanding of the parties.[1] So, a misunderstanding whether a third party is bound will defeat the presumption,[2] and fraud of course will defeat it.[3] But it is immaterial that the former note, representing the pre-existing indebtedness, should not have been surrendered on the giving of the new note. The retention of the original note will not affect the transaction as one of payment, if it be so in fact.[4]

[1] Follett *v.* Steele, 16 Vt. 30; Farr *v.* Stevens, and Collamer *v.* Langdon, supra.

[2] Dickinson *v.* King, 28 Vt 378; Wemet *v.* Mississquoi Co. 46 Ib. 460; Wait *v.* Brewster, supra.

[3] Hutchins *v.* Olcott, Farr *v.* Stevens, Wemet *v.* Mississquoi Co., Wait *v.* Brewster, supra.

[4] Dixon *v.* Dixon. 31 Vt. 450.

CHAPTER IV.

ACCOMMODATION PAPER AS COLLATERAL SECURITY.

§31. The title of the pledgee of accommodation paper.
32. The paper included in the term "accommodation."
33. As collateral security for a present advance.
34. As collateral security for a pre-existing debt.
35. The rule adopted in New York.
36. The rule in Ohio and Pennsylvania.
37. The English rule.
38. Misappropriation of accommodation paper as collateral security.
39. Such pledges not sustained as collateral security for antecedent debt, without more.
40. Pledgee chargeable with notice of fraud or forgery can not recover.
41. Pledge of accommodation paper, after maturity, supported.
42. The amount of recovery by the pledgee.

§31. The Title of the Pledgee of Accommodation Paper.—The title of the pledgee, receiving accommodation paper as collateral security, as a holder for value in the usual course of business, where there has been no restriction placed upon the use of such paper by the party signing or indorsing the same, is especially favored in commercial law. The use of such paper as collateral security for a present advance, or for an antecedent debt, even in states where ordinary commercial paper taken as collateral security for such antecedent debt, without more, is subject to equities, is supported, and the obligation of the accommodating party who has held himself out to the world as absolutely bound to every person who shall take the note for value, is enforced in his favor.[1] The pledgee, receiving such paper, after ma-

[1] Logan *v.* Smith, 62 Mo. 455; Continental Nat. Bank *v.* Townsend, 87 N. Y. 9; Southwick *v.* First Nat. Bank, 84 Ib. 420, 436; Grocer's Bank *v.* Penfield, 69 N. Y. 502; Miller *v.* Larned, 103 Ill. 562; Pitts *v.* Fogle-

turity, as collateral security where the accommodated party has been allowed to retain the same by the maker, is protected, as his continued possession thereof creates a presumption that he has a continued right to use the paper.[1] Where, however, the act of pledge of accommodation paper is a fraud, and in violation of restrictions placed upon its use, the pledgee for value, without notice, is restricted in his recovery against the accommodating party to the amount of his loan; and if chargeable with notice of the fraud, acquires no title whatever as against the defrauded party.[2]

§32. The Paper Included within the Term "Accommodation."—Accommodation paper includes a negotiable or non-negotiable bill or note made or indorsed by a person without consideration,[3] and includes the handing by a person of his signature upon a blank piece of paper to another, authorizing him to fill it up, which being done, as between the accommodating party and an innocent pledgee before maturity, without notice, and for a valuable advance in the usual course of business, the accommodating party is estopped to deny his signature.[4] Where a note is signed

song, 37 Ohio St. 676; Matthews *v.* Rutherford, 7 La. Ann. 225; Lord *v.* Ocean Bank, 20 Pa St. 384.

[1] Connerly *v.* Planters' Ins. Co. 66 Ala. 432; Dunn *v.* Weston, 71 Me. 270; Miller *v.* Larned, 103 Ill. 562; Silverman *v.* Bullock, 98 Ib. 11; Robbins *v.* Richardson, 2 Bosw. 283; Harrington *v.* Dow, 3 Robt. 275.

[2] Maitland *v.* Bank, 40 Md. 540; Allaire *v.* Hartshorn, 21 N. J. L. 665; Dresser *v.* Railroad Co. 93 U. S. 92, 96; Fisher *v.* Fisher, 98 Mass. 303; Stoddard *v.* Kimball, 6 Cush. 469; Small *v.* Smith, 1 Denio, 583.

[3] Dayton National Bank *v.* Merchants' National Bank, 37 Ohio St. 208; Miller *v.* Larned, 103 Ill. 562; Davis *v.* Randall, 115 Mass. 547; Agawam Bank *v.* Strever, 18 N. Y. 502; Richardson *v.* Rice, 9 Baxter 290; Baldwin *v.* Ely. 9 How. 580; Matthews *v.* Finley, 7 La. Ann. 225; Heywood *v.* Watson, 4 Bing. 496. "An accommodation bill or note is one to which the accommodating party has put his name without consideration, for the purpose of accommodating some other party who is to use it and is expected to pay it.' Byles on Bills, Sharswood's Ed. 237.

[4] Goodman *v.* Simonds, 20 How, 361; Violet *v.* Patton, 5 Cranch 142;

by two persons jointly, one being an accommodation maker, and the other receives the same and indorses it before maturity to a bona fide holder for value, in the usual course of business, the accommodating party is bound.[1] Nor is the character of accommodation paper changed because the makers or indorsers thereof are protected against personal loss by securities alleged to be equitably owned by the party accommodated.[2] Nor is it any defense for the accommodation maker, when it is sought to enforce his obligation, that the creditor holds other securities more than sufficient for his protection.[3]

§33. As Collateral Security for a Present Advance.—Accommodation paper, in the hands of the party accommodated, without restrictions as to its use, may be negotiated as collateral security for a debt then created by the holder, or to become due, or in payment of antecedent debt, and the person making, indorsing or accepting the same as an accommodation party, has no defense as against the pledgee for value, before maturity, without notice of equi-

Bank of Pittsburgh *v.* Neal, 22 How. 107; Davidson *v.* Lanier, 4 Wall. 457; Michigan Bank *v.* Eldred, 9 Ib. 544, 552; Angle *v.* N. W. Ins. Co., 92 U. S. 330; Bank *v.* Kimball, 10 Cush. 373; Joseph *v.* Nat. Bank, 17 Kan. 756; Ives *v.* Farmers' Bank, 2 Allen 236; Mahone *v.* Central Bank, 17 Ga. 111; Rich *v.* Starbuck, 51 Ind. 87; Spitler *v.* James 32 Ib. 202; Coburn *v.* Webb, 56 Ib. 96; Jones *v.* Shelbyville Ins. Co., 1 Metc. 58; Bank *v.* Curry, 2 Dana 142; Dunham *v.* Clogg, 30 Md. 284; Hardy *v.* Norton, 66 Barb. 527; Seymour *v.* Mickey, 15 Ohio St. 575; Grissom *v.* Fite, 1 Head. 332; Waldron *v.* Young, 9 Heisk. 777; Nichol *v.* Bate, 10 Yerg. 429; Diereks *v.* Roberts, 13 S. C. 338; Michigan Ins. Co. *v.* Leavenworth, 30 Vt. 11; Frank *v.* Littlefield, 33 Gratt. 384; Snyder *v.* Van-Deuren, 46 Wis. 602; Collett *v.* Emmett, 1 H. Bl. 313; Montague *v.* Perkins, 22 E. L. & E. 516; s. c. 22 L. J. C. P. 187.

[1] First Nat. Bank *v.* Fowler, 36 Ohio St. 524; Wallace *v.* Jewell, 21 Ib. 163; Boyd *v.* Brotherson, 10 Wend. 93; Pearson *v.* Stoddard, 9 Gray, 199; McCrary *v.* Cashey, 27 Geo. 54; Taylor *v.* Strickland, 37 Ala. 642; Kelsey *v.* Hibbs, 13 Ohio St. 340; Goldshede *v.* Swan, 1 W. H. & G. 154.

[2] Miller *v.* Larned, 103 Ill. 562; Silverman *v.* Bullock, 98 Ib. 111.

[3] Lyon *v.* Huntington Bank, 12 S. & R. 61.

ties.[1] The Supreme Court of Ohio, in a recent case,[2] stated the rule as follows: "Where one, not induced by fraud, indorses a negotiable promissory note for the accommodation of another, without restriction as to its use, a third person who receives it before due as collateral security for a debt to become due from the person for whom the indorsement was made, and subsequently prosecutes an action against such indorser, will not be affected in respect to his right to recover, by the fact that such defendant is an accommodation indorser. The obligation of the indorser in such case is held to be the same whether the indorsement was for value received or for accommodation."[3] A payee of an accommodation note, under an agreement with the maker, gave collateral security to the person discounting the note, who had no knowledge that it was accommodation paper. Afterwards, the payee agreed that the collateral securities might be held to secure other obligations. The accommodation maker was held not entitled to require the application of the collateral securities to the accommodation note as against the party discounting it.[4]

§34. As Collateral Security for an Antecedent Debt.—The freedom of use and credit accorded to accommodation paper, when given to the accommodated person without restriction upon its use, has led it to be treated, when indorsed and delivered as collateral security for antecedent debt, with greater favor in connection with such use than the ordinary negotiable instrument issued for value. The undertaking of the accommodating party is liberally construed. Even in the states where the restricted rule pre-

[1] Logan *v.* Smith, 62 Mo. 455.

[2] Pitts *v.* Foglesong, 37 Ohio St. 676.

[3] Stone *v.* Vance, 6 Ohio, 246; Riley *v.* Johnson, 8 Ib. 526; Williams *v.* Bosson, 11 Ib. 62; Clinton Bank *v.* Ayres, 16 Ib. 282; Portage County Bank *v.* Lane, 8 Ohio St. 405; Erwin *v.* Schaffer, 9 Ib. 43; Knox County Bank *v.* Lloyd, 18 Ib. 353; Kingsland *v.* Pryor, 33 Ib. 19.

[4] Tyler *v.* Bussey, 3 MacArth. (D. C.), 344.

vails, under which the indorsee of ordinary commercial paper receiving the same as collateral security for an antecedent debt, without more, is not a holder for value, the pledgee of accommodation paper, receiving the same as collateral security under the like circumstances, before due, properly indorsed, and without notice, is a holder for value, in the usual course of business, and entitled to enforce the same free from antecedent equities. Nor is it necessary that the pledgee of accommodation paper under such circumstances should have parted with value, in order to be within the rule.[1] The existence of the debt secured is a sufficient consideration to support the title of the pledgee to the collateral securities.[2]

§ 35. THE RULE ADOPTED IN NEW YORK.—The use of accommodation paper as collateral security for an ante-

[1] Continental Nat. Bank *v.* Townsend, 87 N. Y. 9; Southwick *v.* First Nat. Bank, 84 Ib. 420, 436; Freund *v.* Bank, 76 Ib. 352; Grocers' Bank *v.* Penfield, 69 N. Y. 502; Schepp *v.* Carpenter, 51 N. Y. 602; Bank of Rutland *v* Buck, 5 Wend. 66; Grandin *v.* LeRoy, 2 Paige, 509; Lathrop *v.* Morris, 5 Sandf. 7; DeZeng *v.* Fyfe, 1 Bosw. 335; Robbins *v.* Richardson, 2 Ib. 248 (in which there was a surrender of other securities); Boyd *v.* Cummings, 17 N. Y. 101; Mohawk Valley *v.* Corey, 1 Hill, 513; Matthews *v.* Rutherford, 7 La. Ann. 225; Appleton *v.* Donaldson, 3 Pa. St. 386; Lord *v.* Ocean Bank, 20 Pa. St. 384; Work *v.* Kase, 34 Ib. 138; Cummings *v.* Boyd, 83 Ib. 372. But in Cummings *v.* Boyd, the Court say that the holder of an accommodation note pledged as collateral security for an antecedent debt is not a purchaser for value, and the note in his hands may be impeached for fraud in its making or procurement. Ashton's App. 73 Ib. 153. Kimbro *v.* Lytle, 10 Yerg. 417; Miller *v.* Larned, 103 Ill. 562; Pitts *v.* Foglesong, 37 Ohio St. 676. The rule in Alabama is to the contrary: that the holder of accommodation paper as collateral security for a pre-existing debt simply is not a holder for value, nor entitled to protection against equities and defences existing between prior parties of which he had no notice. Connerly *v.* Planters' Ins. Co., 66 Ala. 432. The Supreme Court follow the established rule in Alabama in its decision, acknowledging that the weight of authority is the other way, and saying: "Whether the rule (as to accommodation paper) could be adopted here without infringing upon the rule so long adopted that it can not be departed from without disturbing transactions which may have commenced, we do not consider."

[2] Lathrop *v.* Morris, 5 Sandf. 7.

cedent debt, without any further consideration, is approved in New York. The rule in such cases was stated in the Grocers' Bank *v.* Penfield,[1] where it was held: "Where a promissory note is made for the accommodation of the payee, but without restriction as to its use, an indorsee taking it in good faith as collateral security for an antecedent debt of the payee and indorser without other consideration, occupies the position of holder for value, and can recover thereon against the maker. The precedent debt is a sufficient consideration for the transfer, and no new consideration need be shown. It is only where the note has been diverted from the purpose for which it was intended by the payee, or some other equity exists in favor of the maker that it is necessary that the holder should have parted with value on the strength of the note, in order to enforce the same."

An accommodation note was received in good faith and without notice of equities, other notes being surrendered to the payee. This was a good consideration, the parties receiving the same being bona fide holders, and the fact that the note was executed for the accommodation of the payee, and fraudulently diverted from the use intended, forming no defense.[2] The rule, as thus limited, is recognized in several cases in New York.[3] A surety is liable on an accommodation note where used as collateral security for an antecedent debt.[4] And, in another case,[5] where promissory notes, made for accommodation, without restriction as to their use, were transferred to the plaintiff on the last day of grace, during banking hours, to be held as collateral security for indebtedness of the payee to the pledgee, and

[1] 69 N. Y. 502.

[2] Nickerson *v.* Ruger, 84 N. Y. 675; s.c. 76 N. Y. 279.

[3] Spencer *v.* Ballou, 18 N. Y. 331; Park Bank *v.* Watson, 42 Ib. 490; Schepp *v.* Carpenter, 51 Ib. 602; Merchants' Nat. Bank *v.* Comstock, 55 Ib. 24; Freund *v.* Bank, 76 N. Y. 352; Southwick *v.* First Nat. Bank, Ib. 349.

[4] Bank of Rutland *v.* Buck, 5 Wend. 66.

[5] Continental Nat. Bank *v.* Townsend, 87 N. Y. 9.

when collected the proceeds to be applied on such indebtedness, the pledgee was regarded as a holder for value. The notes were transferred before maturity, the maker having the whole of the last day of grace in which to pay them.[1] A different view has been expressed in a Massachusetts case.[2]

§ 36. The Rule in Ohio and Pennsylvania.—The Supreme Court of Ohio considered the liability of an accommodating indorser, where the paper has been used as collateral security for an antecedent debt, for the first time in the case of Pitts *v.* Foglesong,[3] and so far extended the rule declared in Roxborough *v.* Messick[4] as to declare that, in the absence of fraud, the indorser of a negotiable promissory note, owned by another, and indorsed for the accommodation of the latter, without restriction as to its use, is liable to an indorsee who receives it in good faith from the owner before due as collateral security for an antecedent debt of such owner, although there be no other consideration for such collateral. In Pennsylvania, the maker of an accommodation note can not set up a want of consideration as a defense against it in the hands of a third person holding it merely as collateral security for an antecedent debt of the payee. The man, as observed by the court in Lord *v.* Ocean Bank[5] who chooses to put himself in the front of a negotiable instrument for the benefit of his friend must abide the consequences, and has no more right to complain if his friend accommodates himself by pledging it for an old debt than if he had used it in any other way. Accommodation paper is a loan of the maker's credit when made with-

[1] Continental Nat. Bank *v.* Townsend, supra; Bank *v.* Penfield, 69 N. Y. 502; Osborne *v.* Moncure, 3 Wend. 170; Hopping *v.* Quinn, 12 Ib. 517; Cayuga Bank *v.* Hunt, 2 Hill, 635; Smith *v.* Aylesworth, 40 Barb. 104; Cothart *v.* Ballard, 41 Ib. 33.

[2] Pine *v.* Smith, 11 Gray, 38.

[3] 37 Ohio St. 676

[4] 6 Ib. 448.

[5] 20 Pa. St. 384.

out restriction as to the manner of its use.[1] The fact that the pledgee holds other security more than sufficient to cover his debt is no defence for the accommodation maker.[2] Where however such paper is misappropriated by an agent as collateral security for his own antecedent debt, the pledgee is not regarded as a holder for value in the usual course of business.[3]

§ 37. The English Rule.—The like rules are applied by English courts, in considering the relations of parties to accommodation bills and notes as to other paper. The pledgee thereof when a party to the instrument, taking the same before maturity in good faith for value advanced and without notice of equities, is a holder for value, in the usual course of business. The negotiation of such paper as collateral security for an antecedent debt was sustained by Baron Parke in Crofts *v.* Beale,[4] although the note in the case being non-negotiable in form was not enforced against the surety. In Watson *v.* Russell, in the Queen's Bench,[5] the rule was announced that a party who by means of a false pretence, or condition which he does not fulfil, procures another party to give him a note or acceptance in favor of a third person, to whom he pays it, and who receives it bona fide for value, the accommodation maker or acceptor remains liable to pay the same, because his acceptance or transfer of the same imparts value prima facie, and he can only relieve himself of his promise to pay the holder by showing that he is not a holder for value, or that he received the instrument in bad faith, or with notice of its infirmity.

[1] Work *v.* Kase, 34 Ib. 138; Appleton *v.* Donaldson, 3 Ib. 381.

[2] Lyon *v.* Huntington Bank, 12 S. & R. 61; Lord *v.* Ocean Bank, 20 Pa. St. 384.

[3] Royer *v.* Keystone Nat. Bank, 83 Pa. St. 248.

[4] Crofts *v.* Beale, 11 C. B. N. S. 172.

[5] B. & S. 34, 40. The chief justice, however, thought the extent of the recovery, where the same had been pledged as collateral security, should be limited to the extent of the debt which the accommodation paper was given to secure.

§38. Misappropriation of Accommodation Paper as Collateral Security.—The pledgee of commercial paper given for accommodation, receiving the same from the holder thereof before maturity, in good faith, for value, and without notice of any equities or fraud, although the accommodation maker has imposed secret restrictions upon its use, and the act of pledge is a misappropriation by the accommodated party, is a holder for value, in the usual course of business, and entitled to enforce such paper to the whole amount of the face thereof, as against all parties thereto. This is an undoubted right of a pledgee for value, but where such paper is received from the accommodated party, and exceeds in its value the amount of the loan, and the pledgee is liable over to nobody for the surplus, if he should collect the whole, his recovery, as against the accommodating party, may be equitably restricted to the actual advance and proper charges. In any other event, as a holder for value, he is entitled to recover the whole amount of the collateral accommodation notes, the presumption being that full value was given therefor.[1] Even where received with knowledge of misappropriation for a greater sum than authorized, the pledgee is allowed to recover, having advanced value thereon, to the extent of the amounts then remaining due, to secure the payment of which the collateral accommodation notes were authorized to be pledged.[2] In cases, however, where fraud intervenes, and the accommodation paper is taken for value as collateral security by a pledgee chargeable with full notice of the fraud, he can not recover, not being a bona fide holder.[3]

To defeat the title of the bona fide pledgee of accom-

[1] Williams *v.* Smith, 2 Hill, 301; Allaire *v.* Hartshorn, 21 N. J. L, 665; Maitland *v.* Bank, 40 Md. 540; Stoddard *v.* Kimball, 6 Cush. 469; Dresser *v.* Railroad Co., 93 U. S. 92, 96; Watson *v.* Cabot Bank, 5 Sandf. 423; Case *v.* Mech. Bld. Assn., 4 N. Y. 166; Small *v.* Smith, Denio, 583; Collins *v.* Gilbert, 94 U. S. 753, 761.

[2] Maitland *v.* Bank, 40 Md. 540.

[3] Collins *v.* Gilbert, 94 U. S. 753, 760; Stoddard *v.* Kimball, 6 Cush. 469; Small *v.* Smith, 1 Denio. 583.

modation paper receiving the same before maturity, for a valuable consideration, and without notice, where such use of the paper by the holder is a misappropriation thereof, and contrary to the restrictions imposed by the accommodating party on its use, such affirmative acts or gross negligence, or knowledge actual or presumptive, of the misappropriation, must be shown as to make the transaction of pledge a fraud.[1] The inference in such cases is, that the pledgee of such accommodation bill or note gave value for it, that being the object for which such paper is given, although the act of pledge be a misappropriation.[2]

A bona fide holder of accommodation paper, for value, before maturity, without notice of equities, receiving the same from a pledgee thereof, is entitled to recover the whole amount, although as between the maker and the payee and pledgee there is a complete defense.[3] Where accommodation paper is given for the purpose of being used as collateral security, for a present loan, it is no defense thereto that it was received by a pledgee as collateral security for an antecedent debt, the purposes of the accommodation party having been obtained, and no fraud being charged;[4] and where the power was to sell, and the note was pledged as collateral security for an antecedent debt, the maker remained liable;[5] as also where the accom-

[1] Jackson *v.* First Nat. Bank, 42 N. J. L. 177; Duncan *v.* Gilbert, 29 N. J. L. 52; Fisher *v.* Fisher, 98 Mass. 303. In the last case, an accommodation promissory note was delivered by the payee to a third party to be discounted for his benefit, but the third party pledged the same as collateral security for his own note not then due, held by the plaintiffs. The pledgees had no knowledge that the note was an accommodation one, nor of the relations existing between any of the prior parties. Judgment was afterwards obtained on the original note by the pledgee, and execution issued. Suit was then brought on the collateral note, and the pledgee was allowed to recover to the extent of the debt secured. Stoddard *v.* Kimball, 6 Cush. 469.

[2] Collins *v.* Gilbert, 94 U. S. 753; Seybel *v.* Bank, 54 N. Y. 291; Percival *v.* Frampton, 2 Cr. M. & R. 183.

[3] Cook *v.* Norwood, 106 Ill. 558.

[4] Lee *v.* First Nat. Bank, 42 N. J. L. 177; Duncan *v.* Gilbert, 29 Ib. 52.

[5] Matthews *v.* Rutherford, 7 La. Ann. 225.

modation paper was pledged for a much larger amount than that authorized.[1]

§39. Such Pledges not sustained for Antecedent Debt, Without More.—Pledges of accommodation paper, in cases of misappropriation, are not sustained in states where the more restricted rule as to the title of the holder of ordinary commercial paper as collateral security for an antecedent debt, without more, prevails. A pledgee, receiving accommodation paper by an act of misappropriation, merely as collateral security, without any further consideration, although without notice and in good faith, is not in such states a holder for value, in the usual course of business. The rule was applied in a case in New York, where restrictions had been placed upon the use of accommodation paper, the pledgee, although receiving the collateral securities before maturity, bona fide and without notice, was not allowed to recover thereon.[2] The original taint of invalidity affects subsequent transactions, as where a pre-existing debt for which collateral notes had been pledged having been discharged, the notes were, by agreement of the parties, retained as collateral security for an overdrawn account. Under this class of decisions, the second transaction was vicious equally with the first.[3] Nor will a pledgee become a holder for value, where, upon a tortious pledge of an accommodation note by an agent, to whom it had been intrusted to get discounted, for his own antecedent debt, the collateral note was afterwards renewed, without consideration.[4] But no recovery was allowed to the maker of an accommodation note wrongfully pledged by one entrusted therewith for a specific purpose as collateral security for his own antecedent debt, who had paid the

[1] Maitland *v.* Bank, 40 Md. 540.

[2] Grocers' Bank *v.* Penfield, 69 N. Y. 502; Freund *v.* Bank, 76 Ib. 352; see Essex Co. Bank *v.* Russell, 29 Ib. 673.

[3] Merchants' Bank *v.* Corliss, 46 Barb. 19.

[4] Royer *v.* Keystone Nat. Bank, 83 Pa. St. 248.

same, and then before the statute of limitations had barred any rights he might have had, but after the relations of the parties had been greatly complicated and changed, brought a suit to recover the money back. The lower court decided in favor of the accommodation maker,[1] but was overruled by the court of appeals.[2]

§40. Pledgee Chargeable with Notice of Fraud or Forgery, can not Recover.—Where accommodation paper is fraudulently misappropriated, and the pledgee receiving the same is chargeable with knowledge, actual or presumptive, of such misappropriation, or where the names of parties to such paper are shown to have been forged, no recovery is permitted as against the injured party. The fraudulent pledge of an accommodation note, purporting to be indorsed by a partnership, for an antecedent debt, where the pledgee was chargeable with notice of the facts, will not entitle the pledgee to recover as against the partner without whose consent the paper was so used.[3] And where accommodation paper was fraudulently misappropriated by a member of a partnership, being received with knowledge of the fraud, and subsequently the maker of the accommodation note, having full knowledge of the fraud, gave a new note in renewal, which he subsequently paid, under the facts, the maker not being liable to pay the first note, his subsequent payment of the note given in renewal created no valid claim on the partnership to reimburse him the amount paid.[4] The accommodation note of an individual partner, secured by a mortgage upon his wife's separate property, the name of the wife being forged upon the note as joint maker, is utterly void as against the wife in the hands even of an innocent holder. The note and

[1] First Nat. Bank *v.* Southwick, 20 Hun. 349.

[2] S. c. 76 N. Y. 352.

[3] Mynahan *v.* Hanford, 42 Mich. 329; but see Maitland *v.* Bank, 40 Md. 540.

[4] Mix *v.* Muggy, 28 Conn. 186.

mortgage are one contract, and the former being void, the wife was discharged.[1]

§ 41. Pledge of Accommodation Paper, after Maturity.—It results from the character and purposes of accommodation paper, that the obliged party, permitted to retain such paper after its maturity, may transfer the same, either absolutely by sale or as collateral security, and the accommodation maker or indorser will have no defense, by reason of such negotiation after maturity as against a bona fide pledgee, advancing a valuable consideration, and taking the same without notice of equities.[2] Where there is no limitation placed upon the time of its use by the accommodated party, no legal presumption arises of an intention to limit such use to the time before its maturity, so long as it remains in the possession of the party accommodated.[3] Nor will a presumption of fraud or mala fides arise where such accommodation paper is negotiated after its maturity by one holding it for his benefit without restrictions, from the fact alone that such paper was overdue.[4] The liability of an accommodation indorser was decided in a New York case to be defeated where such note was retained by the accommodated party until after its maturity, nor was an indorsee of such note, although paying full value, receiving the same dishonored, entitled to enforce it as against such

[1] Mersman *v.* Werger, 1 McCrary, 528.

[2] Miller *v.* Larned, 103 Ill. 562; Silverman *v.* Bullock, 98 Ib. 11; Harrington *v.* Dow, 3 Robt. 275; Robbins *v.* Richardson, 2 Bosw. 253.

[3] Dunn *v.* Weston, 71 Me. 270; First National Bank *v.* Grant, 71 Ib. 374; Robbins *v.* Richardson, 2 Bosw. 253; Harrington *v.* Dow, 3 Rob. 275. There can be no inference or presumption that such paper is to become valueless, or that the authority of the person entrusted with its use ceases, if it is not negotiated before its maturity. Negotiation after maturity may serve the very purpose of its making—in that way only it may be the intended loan of credit can be made effectual. Connerly *v.* Planters' Ins. Co., 66 Ala. 432.

[4] Brown *v.* Mott, 7 Johns. 361; Lincoln *v.* Stevens, 7 Metc. 529; Connerly *v.* Planters Ins. Co. supra; Charles *v.* Marsden, 1 Taunt. 224.

indorser. The defense of want of consideration attaches to the note after maturity in the hands of any holder.[1]

§ 42. The Amount of Recovery by the Pledgee.— Where an accommodation bill or note, upon which no restriction as to the mode or time of its use has been placed by the accommodating party, has been transferred as collateral security, in good faith, in the usual course of business, the pledgee holding for value is entitled to recover the full amount thereof, although he may have had knowledge that it was accommodation paper.[2] But if he is chargeable with knowledge that the paper was intended to be pledged for a specified debt, and accepts it as collateral security for a larger sum, his recovery is confined to the sum actually intended to be secured.[3] The presumption is, both where the note is taken as collateral security for a debt then created as well as where it is taken as collateral security for an antecedent debt, that the holder paid full consideration for the note. It is upon the defendant to prove, in order to overcome this presumption, that the holder did not give full consideration for it.[4] The pledgee of such negotiable accommodation paper holding the same as collateral security

[1] Chester *v.* Dorr, 41 N. Y. 279.

[2] First Nat. Bank *v.* Grant, 71 Mo. 374; Dunn *v.* Weston, Ib. 270; Robbins *v.* Richardson, 2 Bosw. 253; Brown *v.* Mott, 7 Johns. 360; Seybel *v.* Bank, 54 N. Y. 291; Harrington *v.* Dow, 3 Rob. 275; Commonwealth *v.* City of Pittsburgh, 34 Pa. St. 496; Smith *v.* Knox, 3 Esp. 46; Lord *v.* Ocean Bank, 20 Pa. St. 384; Newberry *v.* Rand, 38 N. H. 166; Maitland *v.* Bank, 40 Md. 540; Stoddard *v.* Kimball, 6 Cush. 469; Fisher *v.* Fisher, 88 Mass. 303; Bowman *v.* Wilson, 58 Ill. 36; Louisiana St. Bank *v.* Gaienne, 21 Lou. Ann. 355; Gardner *v.* Maxwell, 27 Ib. 561. In Mechanics' Bank *v.* Barnett, 27 Lou. Ann. 177, the pledgee was only given the amount of his advances.

[3] Maitland *v.* Bank, 40 Md. 540.

[4] Duncan *v.* Gilbert, 29 N. J. L. 521; Collins *v.* Gilbert, 94 U. S. 753, 751. Where an accommodation note was pledged as collateral security for letters of credit, the holder was not required to show that his actual advances had reached the amount of the letters of credit, in order to enable him to recover the face of the note if the letters of credit were still unrevoked and his liability continued. Allaire *v.* Hartshorne, 21 N. J. L. 566.

for an antecedent debt simply, in good faith, although a holder for value, is, under an equitable rule, permitted only to recover as against the accommodating party the amount of his advances thereon, where less than the value of the collateral securities. Unless accountable to some third person for any surplus, no reason exists why the pledgee should recover any more than the balance of the debt for which he is a holder for value.[1] The recovery was similarly restricted, in a case where the note thus assigned was tainted with usury.[2]

[1] Cromwell *v.* County of Sac, 96 U. S. 51, 60; Allaire *v.* Hartshorne, 21 N. J. L. 665; Williams *v.* Smith, 2 Hill, 301; Chicopee Bank *v.* Chapin, 8 Met. 40; Stoddard *v.* Kimball, 6 Cush. 469; Atkinson *v.* Brooks, 26 Vt. 569; Tarbell *v.* Sturtevant, Ib. 513; Grocers' Bank *v.* Penfield, 69 N. Y. 502; Maitland *v.* Citizens' Nat. Bank, 40 Md. 570; Grant *v.* Kidwell, 30 Mo. 455; Atlas Bank *v.* Doyle, 9 R. I. 76; Mayo *v.* Moore, 28 Ill. 428; Steere *v.* Benson, 2 Bradw. 560; Jones *v.* Heffert, 2 Stark. 356.

[2] Taylor *v.* Daniels, 38 Ill. 331.

CHAPTER V.

NEGOTIABLE BONDS AND COUPONS AS COLLATERAL.

§43. The pledgee of negotiable bonds and coupons a holder for value.
44. No title acquired by pledgee upon bonds totally void.
45. The rule as to "registered" bonds.
46. The pledgee of negotiable bonds, when subject to equity.
47. The negotiability of severed coupons.
48. The title of the pledgee of negotiable coupons, overdue.
49. The title of bona fide holders, pledgees of "debentures."

§ 43. The Pledgee of Negotiable Bonds and Coupons a Holder for Value.—Bonds issued by a municipal or other corporation under statutory authority, and made payable to "bearer" or "holder," are valid commercial instruments, and a pledgee receiving the same before maturity, for a valuable consideration, without notice of equities in the usual course of business, is vested with the legal title thereto, free of prior equities between antecedent parties, as in the case of negotiable promissory notes and bills of exchange. The title of such pledgee, so advancing a valuable consideration, upon the faith and credit of the representations of such negotiable collateral securities, in good faith, is good against the world.[1] Being negotiable in-

[1] White *v.* Railroad Co., 21 How. 575; Mercer Co. *v.* Hacket, 1 Wall. 83; Gilpecke *v.* City of Dubuque, Ib. 175; Myer *v.* City of Muscatine, Ib. 384; Murray *v.* Lardner, 2 Ib. 110; Thompson *v.* Lee County, 3 Ib. 327; Supervisors *v.* Schenck, 5 Ib. 772; Marion County Commissioners *v.* Clark, 94 U. S. 278; Brooklyn *v.* Ins Co., 99 U. S. 362, 370; Copper *v.* New Jersey City, 44 N. J. L 634; Boyd *v.* Kennedy, 38 Ib. 146; Arents *v.* Commonwealth, 18 Gratt. 750; De-Voss *v.* Richmond, Ib. 338; Beaver Co. *v.* Armstrong, 44 Pa. St. 63; McElrath *v.* P. & S. R. Co., 55 Ib. 189, 206; Greenwell *v.* Hayden, 78 Ky. 332; Town of Eagle *v.* Cohn, 84 Ill.

struments, where one person, without notice of equities, advances value thereon, in the usual course of business, a second person, who acquires the same from him before due, for value, is vested with a legal title, although with notice, because he receives a new and independent title from such previous holder for value without notice.[1] Where the power to issue negotiable bonds by municipal or other corporations is to be exercised in a special manner, or subject to certain regulations, conditions or qualifications; and upon the face of the bonds it is recited that they are issued in conformity with such regulations, conditions or qualifications; and it is the sole province of the officers or agents of the municipality executing such bonds, to decide whether or not there was an antecedent compliance with such regulations, conditions or qualifications, the equitable doctrine of estoppel is applied. Such corporation is estopped to deny the truth of the recitals appearing on the face of its negotiable bonds as against a bona fide holder before maturity, who has advanced value on the faith thereof.[2] Where however parties have notice and knowledge of the non-performance of essential conditions by the party issuing the same, the holder is not protected against equities.[3]

A municipal or other corporation which has paid interest for several years on its negotiable bonds, without objection, is estopped by its affirmative acts, amounting to a ratification thereof, to dispute the validity of them, in the hands of

293; Garvin *v.* Wiswell, 83 Ib. 218; P. & S. R. R. Co. *v.* Thompson, 103 Ib. 205; Brainerd *v.* Railroad Co., 25 N. Y. 496; Dinsmore *v.* Duncan, 57 Ib. 573; Evertson *v.* National Bank, 66 Ib. 14; Claflin *v.* South Carolina R. R. Co., 4 Hughes, 12; Third Nat. Bank *v.* Seneca Falls, 15 Fed. Rep. 779; Higgs *v.* Assam Co., L. R. 4 Ex. 387; In re Blakesley, L. R. 3 Ch. 154; Rumball *v.* Metropolitan Bank, L. R. 2 Q. B. D. 194; In re Cork etc. Ry. Co., L. R. 4 Ch. 748.

[1] Montclair *v.* Ramsdell, 107 U. S. 147; Marion County Comm. v. Clark, 94 U. S. 278; Bailey *v.* Bidwell, 13 M. & W. 15.

[2] Joseph Township *v.* Rogers, 16 Wall. 659; Town of Colona *v.* Eaves, 92 U. S. 784; Marion County *v.* Clark, 94 Ib. 278; Hackett *v.* Ottawa, 99 Ib. 86; Ottawa *v.* National Bank, 105 U. S. 342.

[3] Ottawa *v.* Carey, 108 U. S. 110; Dixon *v.* Field, 111 Ib. 89.

bona fide holders, advancing money thereon, without notice of equities.[1] Nor will mere irregularities in the organization of the municipal or other body issuing the same, defeat the title of holders of bonds for value where otherwise legally issued.[2] Nor the failure by the officers of a munipal or other corporation to follow special directions in relation to particular bonds where a holder for value is not chargeable with notice.[3]

§44. No Title acquired by Pledgee, Upon Bonds totally Void.—In cases of the issue of negotiable bonds and coupons, by municipal or other corporations, where there is a total want of power on the part of such municipal or other corporation to issue the same, notice thereof is chargeable upon all persons dealing therewith, and no right, title, or interest, can be acquired even by persons advancing money thereon, as against such municipal or other corporation upon any negotiation thereof.[4] In the absence of statutory authority, municipal or other corporations are without power to issue negotiable bonds and coupons.[5] Nor can a municipal or other corporation, without such authority, issue its bonds in aid of an object clearly extraneous to its legitimate purposes. Every person dealing in such bonds must at his peril take notice of the existence and terms of the law under which is claimed the power of issue, whether value be paid or advanced or not, upon such securities.[6] But where the issue of bonds by agents

[1] County of Clay *v.* Society for Savings, 104 U. S. 579, 591; Supervisor *v.* Schenck, 5 Wall. 772; Whiting *v.* Town of Potter, 18 Blatchf. 105, 165, 180; Bank *v.* Seneca Falls, (C. C. U. S. N. Y. 1883) 15 Fed. Rep. 783; Society *v.* New London, 29 Conn. 174.

[2] Savings Bank *v.* Roscoe, 75 Mo. 408.

[3] Devoss *v.* Richmond, 18 Gratt. 338.

[4] East Oakland *v.* Skinner, 94 U. S 255.

[5] Merrill *v.* Town of Monticello, 14 Fed. Rep. 628; Hepper *v.* Covington, 8 Fed. Rep. 777.

[6] South Ottawa *v.* Perkins, 94 U. S. 260; Pendleton County *v.* Amy, 13 Wall 297; Kennicott *v.* Supervisors, 16 Ib. 452; St. Joseph *v.* Rogers, Ib. 644; Colona *v.* Eaves, 92 U. S. 784.

appointed by a municipality is, in the beginning, irregularly or insufficiently authorized, a municipal or other corporation, having power to appoint such agents to issue for them such obligations, may, like individuals, adopt and ratify, and thus make valid the acts of their agents, and estop themselves, as against pledgees of such bonds, for value, to set up any defenses.[1]

§45. The Rule as to Registered Bonds.—A different rule is applied to "registered" bonds for the payment of money by municipal or other corporations, which are but quasi negotiable instruments, being made payable to a particular person, or "assigns," and not to "bearer" or "holder." Such bonds are like shares of stock, and usually books of registration and transfer are kept, and the transfer of such bonds is generally covered by statutory charter provisions, and are also by the terms thereof, transferable only upon such books. A full legal title thereto, as against third parties, can only be acquired by a transfer thereon. Until such transfer is made, the assignee receives an equitable title only, and the bonds are subject to all the defenses to which they would have been subject in the hands of prior holders.[2] Other bonds are sometimes issued by corporations, payable to bearer, which may, at the option of the holder, be registered on the books of the company, a certificate thereof being indorsed on the bond by the transfer agent of the company. After such registration, no transfer, except upon the books of the company, conveys the legal title thereto as against third parties; but such transfer may, usually at the

[1] Knox Co. *v.* Aspinwall, 21 How. 544; Zabriskie *v.* Railroad Co. 23 How. 381; Supervisors *v.* Schenck, 5 Wall. 772, 781; Pendleton Co. *v.* Amy, 13 Ib. 296; County of Clay *v.* Society of Savings, 104 U. S. 579; Johnson *v.* Stark Co. 24 Ill. 90; Stuart *v.* School Dist. 30 Mich. 69; Tash *v.* Adams, 10 Cush. 252; Peterson *v.* Mayor, 17 N. Y. 449; Hoyt *v.* Thompson, 19 Ib. 208; Calhoun *v.* Delhi Ry Co., 28 Hun. 379; Society for Savings *v.* New London, 29 Conn. 174; N. Y. & N. H. R. R. Co. *v* Schuyler, 34 N. Y. 30, 49.

[2] Cronin *v.* Patrick Co. 4 Hughes, 524; DeVoss *v.* Richmond, 18 Gratt. 338.

election of the holder, be made to bearer, restoring negotiability to the bond. This power of registration, and the conditions thereof, generally appear on the face of the bond, and covers any number of successive transfers and registrations.

§46. The Pledgee of Negotiable Bonds, when Subject to Equities.—Negotiable bonds and coupons, when received after due, as collateral security upon an advance, or as collateral security for an antecedent debt, are subject in the hands of the pledgee to the like equities and defenses as other instruments of commerce, bills of exchange and promissory notes. The pledgee, receiving such collaterals after maturity, obtains no better title or greater interest therein than the pledgor, and is subject to the defenses available against the holders, although for value, of dishonored paper.[1] The like rule is applied to bonds and treasury notes of the United States, payable to bearer at a definite time when transferred after maturity. The title of the holder is subject to the equities of antecedent parties to the same extent as in the case of other commercial paper, indorsed after maturity.[2]

The presence of unpaid coupons upon a bond is not of itself sufficient evidence of dishonor of the bonds to which they are attached, to destroy negotiability, and does not render a pledgee taking the same as collateral security, in good faith, and without notice, subject to equities between the original parties.[3] The recovery of the pledgee, whether the loan be made at the time, or the bonds be received as collateral security for a precedent debt, may be limited

[1] Texas *v.* White, 7 Wall. 700; Texas *v.* Hardenbergh, 10 Ib. 90; Parsons *v.* Jackson, 99 U. S, 440; Stern *v.* Germania Nat. Bank, 34 La. Ann. 1119; Greenwell *v.* Hayden, 78 Ky. 332.

[2] Vermilye *v.* Adams Exp. Co., 21 Wall. 139.

[3] Cromwell *v.* County of Sac, 96 U, S. 51, 58; Nat. Bank of N. A. *v.* Kirby, 108 Mass. 497; Boss *v.* Hewitt, 15 Wis. 260; Indiana & Ill. Cent. R. Co. *v.* Sprague, 103 U. S. 756, distinguishing Parsons *v.* Jackson, supra.

to the amount actually advanced or secured, in cases where the pledgee, although holding an absolute title to the negotiable collaterals, is or can not be responsible over either to the pledgor or to other parties should he recover the entire face value of the collateral.[1] The negotiability of such bonds, when payable to bearer, carries with it a guarantee free of equities existing between the original parties.[2] A bond made payable to a certain person, and after maturity, upon consideration, further time was given, the corporation indorsing on the bond under its seal that it would pay the same to "bearer." The indorsement rendered the bond negotiable.[3]

§47. The Negotiability of Severed Coupons.—The coupons or warrants for interest generally attached to corporation or municipal bonds, are usually made payable to "bearer," and are negotiable equally with the bond. When severed, they cease to be mere incidents of the bonds, and become independent claims, assimilating to negotiable promissory notes. Their validity, negotiability, or ability to support separate actions on the promises contained therein, is not lost or destroyed, although the bonds with which they were issued be, for any cause, canceled or paid before maturity.[4] Suit may be maintained upon them in advance

[1] Cromwell *v.* County of Sac., supra, per Field, J; Stoddard *v.* Kimball, 6 Cush. 468; Allaire *v.* Hartshorne, 1 Zab. 665; Chicopee. Bank *v.* Chapin, 8 Met, 40; Williams *v*, Smith, 2 Hill 301.

[2] In re Agra & Masterman's Bank, L. R. 2 Ch. App. 397; In re Blakeley Ordnance Company, L. R. 3 Ch. App. 154.

[3] Manufacturing Co. *v*, Bradley, 105 U. S. 175; Langston *v.* S. C. Ry Co., 2 S. C. 248; Bank *v.* Railroad Co., 5 Ib. 156; Bonded Debt Cases, 12 Ib. 200, 250.

[4] Town of Thompson *v.* Perrine, 106 U.S.259; Walnut *v.* Wade, 103 Ib. 696; Brooklyn *v.* Insurance Co., 99 Ib. 362; County of Ray *v.* Vansycle, 96 Ib. 675; Cromwell *v.* County of Sac, 94 Ib. 351, 362; Clark *v.* Iowa City, 20 Wall. 583; Aurora City *v.* West, 7 Ib. 82; Thompson *v.* Lee County, 3 Ib. 327; Gelpecher, Dubuque, 1 Ib. 175; Knox County *v.* Aspinwall, 21 How. 533; White *v.* Railroad Co., Ib. 575; Moran *v.* Miamie County, 2 Black 722; Third National Bank *v.* Seneca Falls, C. C. U. S. N. Y. 1883, 15 Fed. Rep. 783;

of the maturity of the principal debt, without any production of the bond, and interest collected upon them from the time of their maturity.[1] The holder is not required to present them at maturity at any certain place which may be designated for payment before suing thereon, but it will be a matter of defense for the company if funds were in readiness at such time and place,[2] and unless the latter conditions are proved, interest will be required to be paid.[3] The rule is otherwise, where such interest coupons contain no negotiable words, nor language from which negotiability can be inferred, or any intention on the part of the corporation to create an obligation independent of the bonds to which they were severally attached when issued, nor will proof of custom be allowed to impart negotiability to such coupons, so issued.[4]

§48. The Title of the Pledgee of Negotiable Coupons, over due.—The right of action upon coupons payable to bearer, and issued with negotiable bonds, whether they remain attached to the bond or have been severed therefrom, begins from maturity.[5] Such coupons, payable to bearer, are, like other negotiable instruments, entitled to days of grace, and a bona fide pledgee, receiving the same

Stern *v.* Germania Nat. Bank, 34 La. Ann. 1119; Gyger *v.* New Orleans 32 La. Ann. 1255; Johnson *v.* Stark County, 24 Ill. 75; Town of Eagle *v.* Kohn, 84 Ib, 292; Pettee *v.* Pratt, 3 Gray 502; Haven *v.* Railroad Co., 109 Mass. 88; McKim *v.* King, 58 Md. 502; Beaver County *v.* Armstrong, 44 Pa. St. 63; National Exchange Bank *v.* Hartford R. R. Co., 8 R, I. 375; Miller *v.* Rutland R. R. Co., 40 Vt. 499; First Nat. Bank *v.* Tabor, 52 Ib. 7; Evertson *v.* National Bank, 66 N. Y. 14.

[1] Amy *v.* Dubuque, 98 U. S. 473; Town of Genoa *v.* Woodruff, 92 Ib. 502; Clark *v.* Iowa City, 20 Wall. 503: City of Lexington *v.* Butler, 14 Ib. 282; City *v.* Lawson, 9 Ib. 477; Gelpecke *v.* City of Dubuque, 1 Ib. 175; Commissioners Knox Co. *v.* Aspinwall, 21 How. 539.

[2] Walnut *v.* Wade, supra; Wallace *v.* McConnell, 13 Pet. 136; Irwin *v.* Withers, 1 Stew. (Ala.) 234; Montgomery *v.* Elliott, 6 Ala. 701. Coupons payable to bearer at a special time and place have all the attributes of negotiable paper. First Nat. Bank *v.* Tabor, 52 Vt. 7.

[3] Walnut *v.* Wade, and Wallace *v.* McConnell, supra.

[4] Myers *v.* Railroad Co., 43 Me. 232; Jackson *v.* Railroad Co., 48 Ib. 147.

[5] Amy *v.* Dubuque, 98 U. S. 473.

before the expiration of the days of grace, for a valuable consideration, without notice of equities, is not subject to defenses attending the transfer of past due commercial paper.[1] Where the bonds to which the coupons are attached when issued have not matured, the latter, although overdue and detached from the bond, do not lose their quality of negotiability by the law merchant. Any one advancing money bona fide thereon before the maturity of the bond, is entitled to sue on them as in the case of the transfer of negotiable paper payable to "bearer."[2] The holders of such coupons are entitled to all the privileges and subjected to all the liabilities attendant upon ordinary commercial paper by the law merchant. Where coupons, payable to bearer, are fraudulently transferred after maturity, the holder receives no better title than his transferror, and the latter having obtained them by fraud or theft, not being the owner, nor authorized to sell or pledge, no title passes by the transfer as against the real owner.[3] Nor can the doctrine of estoppel be invoked to protect the holder as against the owner's claims.[4]

The bona fide holder of coupons payable to bearer, transferred for a valuable consideration, is not chargeable with notice of the conditions upon which they were issued, nor of the resolutions on the record books of the company issuing the same.[5] Nor is it any defense against such detached coupons in the hands of a bona fide holder advancing value without notice that the railroad company did not construct the line it agreed to as the consideration for the bonds and coupons,[6] nor that informalities were committed in the execu-

[1] Evertson *v.* Nat. Bank, 66 N. Y. 14.

[2] Town of Thompson *v.* Perrine, 106 U. S. 259.

[3] McKim *v.* King, 58 Md. 502; Stern *v.* Germania Nat. Bank, 34 La. Ann. 1119; Texas *v.* White, 7 Wall. 700; Vermilye *v.* Adams, 21 Ib. 143; Texas *v.* Hardenburg, 10 Ib. 90; Parsons *v.* Jackson. 99 U. S. 440; Henderson *v.* Case, 31 La. Ann. 215.

[4] Toby *v.* Smith, 6 Wall. 493; Stern *v.* Germania Nat. Bank, supra; Bird *v.* Cockrem, 28 La. Ann. 70.

[5] Johnson *v.* Stark County, 24 Ib. 75; Town of Eagle *v.* Kohn, 84 Ib. 392.

[6] Brooklyn *v.* Ins. Co., 99 U. S. 362.

tion or delivery thereof.[1] Nor will questions of form merely, or irregularity, or fraud, or misconduct on the part of agents, constitute a defense as against a holder for value.[2] But where upon their face the coupons refer to the bonds to which they were attached, and purport to be for the semi-annual interest accruing thereon, the holder is chargeable with notice of the contents of the bond.[3]

§49. The Title acquired by Bona Fide Holders, Pledgees, to "Debentures." — English "debentures" have many of the features of American bonds. They are instruments showing that the corporation issuing them owes money, and is bound to pay; and being negotiable in character, a bona fide pledgee advancing funds upon the credit of such representations, without notice, is not subject to any equities or defenses existing between the company and the original holder.[4] Vice-Chancellor Malins, in re Imperial Land Company,[5] said: "Every principle of public policy calls upon me to repudiate the notion that such documents are to be treated like bonds or choses in action in which the equities between the parties can be entered into." Where, in accordance with a previous contract, debentures were issued professing to be payable to bearer and negotiable as money, the bona fide holders thereof were not subject to equities existing between the company issuing the debentures and the parties with whom the contract of loan was made,[6] nor even where the debentures were acquired after an order had been entered for the winding up of the company issuing the same, when taken without notice.[7]

[1] Wilson *v.* Salamanca, 99 U. S. 499.

[2] East Lincoln *v.* Davenport, 94 U. S. 801; Third National Bank *v.* Seneca Fall, 15 Fed. Rep. 783.

[3] McClure *v.* Oxford, 94 U. S. 429; George *v.* Oxford, 16 Kan. 72.

[4] In re Imperial Land Co., L. R. 11 Eq. 478; Ex parte City Bank, L. R. 3 Ch. 758; Higgs *v.* Assam Tea Co. L. R. 4 Ex. 387.

[5] In re Imperial Land Company, supra, p. 490.

[6] In re Blakeley Ord. Company, L. R. 2 Ch. 154.

[7] In re Imperial Land Company, supra.

The advantages of negotiability do not follow debentures where made payable to a certain person named, "or to his executors, administrators, or transferees, or to the holder for the time being," the word "transferees" meaning "assigns," and assignments being required to be by deed, and the other words "holder for the time being" being inserted to avoid the expense of making transfers by deed, and not for the purpose of placing such holder in a better position as to equities than an assignee by deed.[1]

[1] In re Natal Inv. Co., L. R. 3 Ch. 355; but a different view of the meaning of "holders for the time being" was held in Alsatt *v.* Farquharson, 10 W. R. 458. And debentures containing a contract in their conditions were held non-negotiable, and the holder of one, in good faith, which proved to have been stolen, was not allowed to recover thereon. Crouch *v.* Credit Foncier, L. R. 8 Q. B. 374.

CHAPTER VI.

PLEDGE OF COLLATERAL SECURITIES BY PARTNERS.

§50. The partner's right to borrow money, and give and receive collateral security.
51. Misappropriation of proceeds of loan by partner.
52. The pledgee, when a creditor of the firm.
53. The use of trust funds and securities by partners.
54. Pledge by partner for his own debt, or debt of third party—Its subsequent ratification.
55. The rule as to guaranties and accommodation paper.
56. The rights of the bona fide indorsee, under such pledge.
57. Notice of misappropriation to charge the pledgee.
58. The recovery of the bona fide indorsee for value.
59. Effect of taking security from individual partner.
60. Release of collateral security of partner, by payment.

§ 50. The Partner's right to Borrow Money and Give and Receive Collateral Security.—Members of an ordinary commercial partnership have a general authority to borrow money upon the credit of the firm, in the usual course of business, and for partnership purposes. Such authority includes the drawing, acceptance and indorsement of bills of exchange, and the making and indorsement of promissory notes, in the name of the firm, upon the sale or pledge of which money may be obtained or the payment of a partnership liability be secured.[1] The exercise of this

[1] Gregg *v.* Fisher, 3 Bradw. 261; Blinn *v.* Evans, 24 Ill. 317; Uley *v.* Ginrich, 57 Ib. 531; Davis *v.* Richardson, 45 Miss. 499; McKee *v.* Hamilton, 33 Ohio St. 7; Leffler *v.* Rice, 44 Ind. 103; Baily *v.* Brownfield, 20 Pa. St. 41; Dow *v.* Moore, 47 N. H. 419; Saltmarsh *v.* Bower, 22 Ala. 221; Wilson *v.* Richards, 27 Minn. 337; Porter *v.* White, 39 Md. 613; Grier *v.* Hood, 25 Pa. St. 430; Ross *v.* Howell, 84 Ib. 129; McNaghten's App. 101 Ib. 204 (15 Rep. 474); Moorehead *v.* Gilmore, 77 Pa. St.

authority may be, however, controlled by the articles of partnership, or by agreements between the partners. Such contracts are sustained as between the parties thereto and parties chargeable with notice thereof; but as against third parties who have advanced value, in good faith, upon such securities, in the usual course of business, without notice, they form no defense. The general authority of partners in commercial undertakings to bind the firm in regard to the sale or pledge of its paper can not be secretly destroyed or restricted to the injury of an innocent indorsee thereof for value.[1] The authority is given to partners in commercial or trading partnerships, and does not extend to farmers, doctors, attorneys, or others of the non-trading class.[2]

The authority of members of a commercial or trading partnership extends also to the transfer or assignment of the property and credit of the firm as collateral security for the payment of moneys advanced to the firm, and its debts and liabilities. The power, being a general one in commercial and trading partnerships, is supported when exercised in the usual course of business, although without the

118; Smith *v.* Collins, 115 Mass. 388; Kimbro *v.* Bulbitt, 22 How. 266; Leroy *v.* Johnson, 2 Pet. 186; Michigan Bank *v.* Eldredge, 9 Wall. 544; Alliance Bank *v.* Kearsley, L. R. 6 C. P. 433, 437; Lane *v.* Williams, 2 Vern. 277, 292; Rothwell *v.* Humphries, 1 Esp. 406; Lloyd *v.* Freshfield, 2 Carr. & P. 325; s. c. 8 Ves. 540; Howkin *v.* Bourne, 8 M. & W. 710; Gordon *v.* Ellis, 7 Man. & Gr. 607; Brown *v.* Kidger, 3 H. & N. 853; Lewis *v.* Reilly, 1 Q. B. 349.

[1] Kimbro *v.* Bullit, 22 How. 266; Michigan Bank *v.* Eldredge, 9 Wall. 544; Bush *v.* Crawford, 7 N. B. R. 299; U. S. Bank *v.* Binney, 5 Mason 176, s. c. 5 Pet. 529; Gregg *v.* Fisher, 3 Bradw. 561; Davis *v.* Richardson, 45 Miss. 499; Laler *v.* Jordan, 44 Ib. 283; Wilson *v.* Richards, 27 Minn. 337; Sylverstein *v.* Atkinson, 45 Miss. 81; Nat. Union Bank *v.* London, 66 Barb. 189; Boswell *v.* Green, 25 N. J. L. 390; Ex parte Holdsworth, 1 M. D. & D. 475; Gleadon *v.* Tinker, Holt N. P. Cas. 586; Howken *v.* Bourne, 8 M. & W. 703.

[2] McCrary *v.* Slaughter, 58 Ala. 230; Hunt *v.* Chapin, 6 Lans. 139; Gray *v.* Ward, 18 Ill. 32; Ulery *v.* Ginrich, 57 Ib. 531; Mix *v.* Muggy, 28 Conn. 186; Crosthwait *v.* Ross, 1 Humph. 23; Breckenridge *v.* Shrieve, 4 Dana, 375; Greenslade *v.* Dower, 7 B. & C. 635; Dickerson *v* Valpey, 10 Ib. 138; Foster *v.* Mackreth, L. R. 2 Ex. 163, 166.

knowledge or consent of the other partners.[1] The assignment of the property of the partnership, or the indorsement of its commercial paper, as collateral security for the payment of an antecedent debt, is within this authority.[2] Even after dissolution, a deposit of collateral securities or of the property of the firm, may be made to complete the contract obligations of the firm by the partner, to whom has been entrusted the settlement of its affairs.[3]

One of two or more partners may, in the conduct of partnership affairs, receive collateral securities for moneys loaned or debts due to the firm. Where the business carried on is that of banking, the acceptance of collateral securities upon a loan of money by one of the partners is such a transaction as would be a part of the ordinary banking business; and in cases of doubt the other partner may, by his acts or by his silence, waive his right to object to any results following the acceptance of such collateral securities with title. Where one of two partners in a banking firm received collateral security for an advance by his firm and taking the title thereto in the name of the firm the better to secure repayment of the money loaned, the other partner making no objection upon learning of the transaction, was equally bound by the liabilities which eventually followed the vesting of the title of the securities in the pledgees.[4]

[1] Harrison *v.* Sterry, 3 Cranch, 289; Hodges *v.* Harris, 6 Pick. 360; Tapley *v.* Butterfield, 1 Met. 515; Russell *v.* Leland, 12 Allen, 349; Denning *v.* Colt, 3 Sandf. 290; Egberts *v.* Woods, 3 Paige, 517; Mabbett *v.* White, 12 N. Y. 442; McClelland *v.* Remsen, 14 Abb. Pr. 335; s. c. 36 Barb. 622; Everett *v.* Strong, 5 Hill, 163; s, c. 7 Hill, 585; Nat. Union Bank *v.* London, 66 Barb. 189; Dana *v.* Lull, 17 Vt. 390; Boswell *v.* Green, 25 N. J. L. 390; Cullom *v.* Bloodgood, 15 Ala. 34; McCollough *v.* Somerville, 8 Leigh, 415; Ormsbee *v.* Davis, 5 R. I. 443; Gregg *v.* Fisher, 3 Bradw. 261; Ex parte Bonbonus, 8 Ves. 540; Brownrigg *v.* Rae, 5 Ex. 489; Gordon *v.* Ellis, 7 Mann. & Gr. 607; Burchart *v.* Dresser, 10 Hare, 453; s. c. 4 De G. M. & G. 542.

[2] Harrison *v.* Sterry, 3 Cranch, 289; Smith *v.* Dennison, 101 Ill. 531; McClelland *v.* Ramsen, 36 Barb. 622; Dana *v.* Lull, 27 Vt. 394.

[3] Burchart *v.* Dresser, 10 Hare, 453; s. c. 4 De G. M. & G. 542.

[4] Weikersheim's case, L R. 8 Ch. 831.

§ 51. Misappropriation of Proceeds of Loan by Partner.—Where one of two or more partners borrows money, in the regular course of business of the firm, and upon its credit by the negotiation of commercial paper, made, indorsed or accepted in its name, and the holder advancing value thereon, takes the same bona fide, for value, before maturity, the liability of the partnership or of the other partners to such holder is not affected by the fact that the money so obtained was in fact misappropriated by the borrowing partner.[1] The presumption is, that negotiable paper made by one partner, in the name of the firm, is made in the course of partnership dealings, and the burden is upon the partnership alleging the contrary, to show that it is not, and that it was received by the holder advancing money thereon, under such circumstances as to charge him with notice.[2]

§ 52. The Pledgee, when a Creditor of the Firm.—The appropriation of the avails of a loan to partnership purposes, where such loan is made to a partner upon his individual credit, who gives his own note or other security for the payment thereof, is not of itself sufficient to create the relation of creditor and debtor between the lender and the partnership, nor to make the partnership liable upon the loan.[3] Even where the other partners are informed of

[1] Winship *v.* Bank, 5 Peters, 529; Blodgett *v.* Weed, 119 Mass. 215; Hayward *v.* French, 12 Gray, 453; Church *v.* Sparrow, 5 Wend. 223; Whittaker *v.* Brown, 16 Ib. 595; Onondago Bank *v.* De Puy, 17 Ib. 47; Alexander *v.* State, 56 Geo. 478; Emerson *v.* Harmon, 14 Me. 271; Waldo Bank *v.* Lambert, 16 Mo. 416; Mifflin *v.* Swift, 17 S. & R. 165; Bailey *v.* Brownfield, 20 Pa. St. 41; Haldeman *v.* Bank of Middleton, 28 Id. 440; Wagner *v.* Freschel, 56 N. H. 495; Smith *v.* Harvie, 31 Ill. 62; Gregg *v.* Fisher, 3 Bradw. 261; Sylverstein *v.* Atkinson, 45 Miss. 81.

[2] Gregg *v.* Fisher, 3 Bradw. 261; Barrett *v.* Swan, 17 Me. 180; Hamilton *v.* Summers, 12 B. Monr. 11; Doty *v.* Bates, 11 Johns. 544; Whittaker *v.* Brown, 16 Wend. 505; Manning *v.* Hays, 6 Md. 5; Miller *v.* Maurice, 6 Hill, 114; Bank *v.* Binney, 5 Mason, 176.

[3] Le Roy *v.* Johnson, 2 Pet. 198; Stockwell *v.* Dillingham, 50 Me. 442; Jaques *v.* Marquand, 6 Cow. 497; Whittaker *v.* Brown, 16 Wend. 505;

the persons from whom such funds were obtained, and of their use in the business of the firm ;[1] nor where bills are drawn up by a partner in his own name, and discount obtained by an agent, the proceeds going to the firm.[2] And where money has been loaned to an individual partner, although the intention be to provide for his share of the partnership capital, and the money is so applied, no liability is created on the part of the firm, the loan not having been made to the firm, nor upon its credit.[3] The decisive question as to the firm liability is, whether it, by one of its partners or otherwise, entered into the contract of loan so as to be chargeable thereunder, and not whether the firm obtained the benefit of the loan made by the partner.[4]

Where such money, however, has been obtained generally, by the individual partner, the fact that the funds thus obtained have been applied to partnership purposes, is prima facie evidence to charge the firm,[5] or where the loan is not made upon the individual credit of the borrowing partner, and it is shown that the money was borrowed for and ap-

Ketchum *v.* Durfee, 1 Hoffm. Ch. 538; Tallmadge *v.* Pennoyer, 35 Barb. 120; Bailey *v.* Clark, 6 Pick. 372; Green *v.* Tanner, 8 Met. 411; Peterson *v.* Roach, 32 Ohio St. 374; Norwalk *v.* Nat. Bank 39 Ohio St. 27 Alb. L. J. 185; Welker *v.* Wallace, 31 Ga. 362; Graff *v.* Hitchman, 5 Watts, 454; Nat. Bank *v.* Day, 12 Heisk. 413; Foster *v.* Hall, 4 Humph. 346; Emly *v.* Lye, 15 East. 7; Bevan *v.* Lewis, 1 Sim. 376; In re Worcester Corn. Ex. Co., 3 DeG. M. & G. 180; Burmester *v.* Norris, 6 Ex. 796; Hawtayne *v.* Bourne, 7 M. & W. 595; In re Ansonia Fibre Co., L. R. 9 Ch. 635.

[1] Ketchum *v.* Durfee, 1 Hoffm. Ch. 538.

[2] Emly *v.* Lye, 15 East, 7.

[3] McNaughten's App. 101 Pa. St. 204 (15 Rep. 454); Donnelly *v.* Ryan, 41 Pa. St. 306.

[4] Beckham *v.* Drake, 9 M. & W. 99; Ernest *v.* Nichols, 6 H. L. Cas. 423; Bank of South Australia case, 8 Barn. & C. 427; Faith *v.* Richmond, 11 A. & E. 339; Le Roy *v.* Johnson, 2 Pet. 186; Peterson *v.* Roach, 32 Ohio St. 374; Bank of Rochester *v.* Monteith, 1 Denio 402; Wright *v.* Hooker, 10 N. Y. 51. The question is, whether the name used, and to which credit is given, is that of the firm, or the name which the firm has adopted and used as the name to designate the partnership; it is only where such name has been used that the members of the firm are held. National Bank of Salem *v.* Thomas, 47 N. Y. 15.

[5] Jaques *v.* Marquand, 6 Cow. 497.

propriated to the use of the firm, notwithstanding the false and fraudulent representations of the borrowing partner relating to the business of the firm by which the money was secured.[1] Where one partner contracts a debt representing to the creditor that the money obtained is for the benefit of the firm, if the contract is within the scope of its business, the firm is liable, whether the representations were true or false.[2] And where money was borrowed by a partner in his own name, his individual note being given, and the money is used for partnership purposes, a note of the partnership given in renewal of the individual note, is such a ratification that the firm is held thereon.[3] Where there was a partnership liability for a debt, evidenced by a note with sureties, and a new note given in renewal signed by one partner alone, with the same sureties, who signed such note on the faith of representations that it was necessary in the business of the firm, and that the other partner would sign it, upon paying the note, the sureties may recover as against the partnership, although the other partner did not in fact sign the note.[4]

§53. The Use of Trust Funds and Securities by Partners.—Where one of two or more partners is a trustee, having the control and management of a trust estate, and fraudulently uses the trust money and securities in the business, but without the knowledge or privity of the other partner or partners that the money so furnished belongs to any trust fund, no joint debt or obligation is created as against the partnership by such use. The act of the partner is a breach and abuse of his trust, but this of itself is not sufficient to change the innocent partners into implied trustees, nor to render them liable as under contract, to the

[1] Stockwell *v.* Dillingham, 50 Me. 442.

[2] Ibid.; Church *v.* Sparrow, 5 Wend. 223; Tucker *v.* Peasley, 36 N. H. 167.

[3] Union Bank *v.* Smith, 7 Paige, 26, 33.

[4] McKee *v.* Hamilton, 33 Ohio St. 7.

cestuis que trust.[1] Where, however, such trust funds or securities are fraudulently loaned by one partner having the control thereof, and the other partners are chargeable with knowledge that such securities are not the individual property of the trustee, the firm, in the event of their loss in the course of its business, is liable to the trust estate for the value of the securities.[2] Knowledge of the other members of a partnership of or privity to such misuse of trust funds or securities, will charge the partnership; aliter, if there be no notice.[3]

§54. PLEDGE BY PARTNER FOR HIS OWN DEBT, OR DEBT OF THIRD PARTY—ITS SUBSEQUENT RATIFICATION. —A member of a partnership has no authority to use the name and credit of the firm to secure the payment of his own indebtedness, or the indebtedness of a third party. A creditor of a partner, receiving the securities of the firm, as collateral security for the individual debt of such partner, or of a third person, does so at his risk and peril, and is not allowed to recover as against the firm, or the remaining partners, except he show their knowledge of the act and consent thereto, or their subsequent ratification.[4] The

[1] In re Jordan, 2 Fed. Rep. 319; Jaques *v.* Marquand, 6 Cow. 497; Hutchinson *v.* Smith, 7 Paige 26; Tallmadge *v.* Pennoyer, 35 Barb. 120; Guillou *v.* Peterson, 9 Phila. 225; Logan *v.* Bond, 13 Geo. 192.

[2] Guillou *v.* Peterson, 9 Phila. 225.

[3] Hutchinson *v.* Smith, 7 Paige 26.

[4] Mutual National Bank *v.* Richardson, 33 La. Ann. 1312; Johnson *v.* Crichton, 50 Md. 108; Livingston *v.* Roosevelt, 4 Johns. 251; Osborne *v.* Stone, 30 Minn. 25 (15 Rep. 52); Selden *v.* Bank, 3 Minn. 166; Rollins *v.* Stevens, 31 Me. 454; Raust *v.* Hauselt, 41 N. Y. Sup. Ct. 467; Williams *v.* Walbridge, 3 Wend. 415; Gansevoort *v.* Williams, 14 Ib. 131; Wilson *v.* Williams, Ib. 146; Stamer *v.* Tyson 3 Hill, 379; Miller *v.* Manice, 6 Ib. 115; Rutledge *v.* Squires, 23 Ia. 53; Hickman *v.* Reineking, 6 Ib. 388; Clay *v.* Cottrell, 18 Pa. St. 408; Cooper *v.* McClushan, 22 Ib. 80; King *v.* Faber, 22 Ib. 21; Baird *v.* Cochrane, 4 S. & R. 397; Williams *v.* Gilchrist, 11 Ib. 535; Robinson *v.* Aldridge, 34 Miss. 352; Hickmen *v.* Hunkle, 27 Mo. 401; Weed *v.* Richardson, 2 Dev. & Bat. 535; Porter *v.* Gunnison, 2 Grant's Cas, 297; Burleigh *v.* Parton, 21 Tex. 585; Powell *v.* Messer, 18 Tex. 401; Tomkyns *v.* Woryard, 5 W. Va. 216; Munroe *v.* Cooper, 5 Pick. 412; Sweetser *v.* French, 2 Cush. 309; Leverson

onus probandi is on the creditor to show such knowledge and consent, or ratification.[1] And where a partner has misappropriated a judgment note, executed by him in the name of the firm, to secure the payment of his own debt, and the same is received by the pledgee with knowledge of the misappropriation, the transaction is held a fraud, not only upon the partners, but upon the creditors of the firm also.[2] The title to such partnership securities, so fraudulently pledged by the individual partner, is not diverted from the partnership, whether the creditor was chargeable with knowledge of the misappropriation or not.[3] No substantial difference exists between taking the note of a firm for a private debt of a partner by a creditor of such partner, thus pledging the credit of the firm, and taking the property of the firm, upon a purchase by one of the partners, to pay his private debt. In both cases, the act is equally injurious

v. Lane, 13 C. B. N. S. 278; Wells *v.* Masterman, 2 Esp. 371; Ex parte Austen, 1 M. D. &. D. 247; Ex parte Bonbonus, 8 Ves. 540; Heilbut *v.* Nevill, L. R. 4 C. P. 354; on appeal, L. R. 4 C. P. 473; Elston *v.* Deacon, L. R. 2. C. P. 20. Where a bill is drawn by one partner in the name of the firm in fraud of his co-partners and is accepted by the drawee, and afterwards paid by the drawer in the name of the firm, the acceptor may successfully deny the endorsement, but not the drawing. Garland *v.* Jocomb, L. R. 8 Ex. 216.

[1] Kendall *v.* Wood, L. R. 6 Ex. 243; Leverson *v.* Lane, 13 C. B. N. S 278; Edwards *v.* Thomas 66 Mo. 468; Stall *v.* Catskill Bank, 18 Wend. 466. In ex parte Golding, cited by Collyer on Partnership, 1st ed. p 283. Lord Lyndhurst said: "No principle can be more clear than that where a partner and a creditor enter into a contract on a separate account, the partner can not pledge the partnership funds or give partnership acceptances in discharge of the contract so as to bind the firm." No fraud was charged in that case. To like effect as to pledge of partnership property and credit, Ridley *v.* Taylor, 13 East, 175. A mere statement by a partner that the money is wanted for the partnership is not sufficient to charge the firm where a partner pledged securities of the firm as indemnity upon an indorsement of his personal note. Uhler *v.* Browning, 28 N. J. L. 79.

[2] McNaughten's App. 101 Pa. St. 204; Purdy *v.* Powers, 6 Ib. 492.

[3] Liberty Savings Bank *v.* Campbell 75 Va. 534; Bemis *v.* Wadill 32 Gratt, 588, 594; Rogers *v.* Batchelor, 12 Pet. 221; Heilbut *v.* Nevill L. R. 4 C. P. 354; on app. Ib. 473; Deardorf *v.* Thatcher, 78 Mo 128.

to the other partners. It is taking their common property to pay a private debt of one of the partners.[1]

Where a partner has wrongfully pledged the credit or effects of the partnership, or has misappropriated its securities for his own individual advantage, the other partner or partners may, by their subsequent affirmative acts, so far ratify and confirm the same as to render the partnership liable. As where a partner had given a promissory note in the name of the firm for his individual debt, and the other partner obtained forbearance in its prosecution by a promise to pay it, a judgment against both was sustained.[2] Or a ratification or recognition of the note so misappropriated, by the remaining partners, is sufficient.[3] Where such note has been ratified by the other partners, and a note in renewal thereof has been given, no further ratification is necessary.[4] The promise of such partners, implied from such ratification, needs no consideration for its support, as it does not come within the Statute of Frauds.[5]

§55. The Rule as to Guaranties and Accommodation Paper.—One of the two partners has no authority, without the consent of his co-partners, to pledge the credit of the firm by signing commercial paper so as to make the firm a surety, indorser, or guarantor of a third person, or to make accommodation acceptances or notes in the name of the firm. Persons receiving such paper with knowledge of or chargeable with notice that the act is a fraudulent pledge of the firm's credit, can not recover as against the other co-partners, without proving their authority or subsequent assent. Except in the hands of bona fide holders for value, before maturity, without notice of the want of authority,

[1] Dob *v.* Halsey, 16 John. 34 (Spencer C. J.); Everingham *v* Emsworth, 7 Wend. 326; Livingston *v.* Roosevelt, 4 Johns. 251; Rogers *v.* Batchelor, 12 Pet. 221; Green *v.* Deakin, 2 Stark. 357,

[2] Wheeler *v.* Rice, 8 Cush. 205.

[3] Jones *v.* Booth, 10 Vt. 268; Sweetzer *v.* French, 2 Cush. 309.

[4] Tilford *v.* Ramsey, 37 Mo. 563.

[5] Commercial Bank *v.* Ramsey, 37 Mo. 563.

such indorsements, or guaranties, or accommodation acceptances, are without validity, and no rights can be acquired thereunder as against the partnership.[1] A person who takes a negotiable note, signed or indorsed as stated, showing upon its face that the firm is a mere surety or guarantor thereon for some third person, does so at his peril, as he is chargeable with notice of every fact to which inquiry would lead, and to be protected must ascertain the authority of the partner to indorse the firm name as surety or guarantor thereon.[2] Such an act is not within the usual course of partnership business, and the burden of affirmatively proving a special agreement authorizing such act is upon the holder, the act of the partner alone not being sufficient.[3] Where a person takes a note showing upon its face that it is made by one partner in the name of the firm, for the accommodation of another person, the holder can not recover as against the other partners, without proving their assent.[4]

§56. The Rights of the Bona Fide Indorsee, under such Pledge.—A bona fide indorsee for value, before maturity, of a negotiable bill or note given by a partner in the name of a partnership, and without notice of the equities arising from the fact that it had been fraudulently transferred for the partner's personal debt, is always protected. If any one should suffer by reason of the fraudulent conduct of the partner in thus misappropriating the firm's credit or property, as against an innocent indorsee of such paper, without notice, it should be the person who has had

[1] Atlas Nat. Bank *v.* Savery, 127 Mass. 275; Sweetzer *v.* French, 2 Cush. 309; Osborne *v.* Stone, 30 Minn. 25 (13 N. W. R. 922); Bank of Rochester *v.* Bowen, 7 Wend. 158; Fieldens *v.* Lahens, 9 Bosw. 445; Evans *v.* Wells, 20 Wend. 254; 22 Ib. 324; Bank of Chemung *v.* Bradner, 44 N. Y. 680; Hendrie *v.* Berkowitz, 37 Cal. 113; Zuel *v.* Bowen, 78 Ill. 234; Marsh *v.* Thompson Nat. Bank, 2 Bradw. 217; Davis *v.* Blackwell, 5 Ib. 32; Rollins *v.* Stevens, 31 Me. 454; First Nat. Bank *v.* Breese, 19 Iowa, 640; Langan *v.* Hewett, 13 S. & M. 122.

[2] Davis *v.* Blackwell, 5 Bradw. 32.

[3] Ibid; Osborne *v.* Carr, supra.

[4] Massachusetts Nat. Bank *v.* Law, 127 Mass. 72.

sufficient confidence to enter into such close commercial relations with him as that of partnership.[1] To support the indorsee's title, he must have advanced value on the faith and credit of the paper in good faith.[2] Nor is it material that the indorser from whom title was acquired to a bill of exchange valid upon its face, had himself notice that it was open to defenses.[3] Evidence will not be received that, by the articles of partnership, one partner had no right to indorse negotiable paper, to defeat the title of a bona fide indorsee for value, of such paper, receiving the same as col-

[1] Blodgett *v.* Weed, 119 Mass. 215; Wait *v.* Thayer, 118 Ib. 474; Warren *v.* French, 6 Allen, 317; Hayward *v.* French, 12 Gray, 453; Chemung Canal Bank *v.* Bradner, 44 N. Y. 680; Michigan Bank *v.* Eldred, 9 Wall. 544; Mechanics' Bank *v.* Foster, 29 How. Pr. 408; Livingston *v.* Roosevelt, 4 Johns. 251; Smith *v.* Lusher, 5 Cow. 688; Evans *v.* Wells, 20 Wend. 254; 22 Ib. 324; Redlon *v.* Churchill, 73 Me. 146; Waldo Bank *v.* Greeley, 16 Ib. 419; Parker *v.* Burgess 5 R. I. 277; Haldeman *v.* Bank, 28 Pa. St. 440; Manufacturers Bank *v.* Winship, 5 Pick. 11; Hogarth *v.* Latham, L. R. 3 Q. B. D., 643; Ellston *v.* Deacon, L. R. 2 C. P. 20; ex parte Bushell, 3 M. D. & D. 615; ex parte Meyer, DeGex, 632 (an accommodation bill); Lane *v.* Williams, 2 Vern. 277; Wintle *v.* Crowther, 1 Cr. & J. 316; Ridley *v.* Taylor, 13 East, 175; Sanderson *v.* Brooksbank, 4 Car. & P. 286; Lewis *v.* Reilly, 1 Q. B. 349; Swan *v.* Steele, 7 East, 210.

[2] Clark *v.* Dearborn, 6 Duer, 309; Munroe *v.* Cooper, 5 Pick. 412; Mix *v.* Muggy, 28 Conn. 186; Blodgett *v.* Weed, 119 Mass. 215. The rule in England is, that if a bill is drawn and accepted by one partner in fraud of the firm, the holder can not recover against the firm unless he can show that he gave value for the bill. Hogg *v.* Shene, 18 C. B. N. S. 426; Bailey *v.* Bidwell, 13 M. & W. 73; Smith *v.* Braine, 15 Jur. 287, Q. B.; Harvey *v.* Towers, 6 Ex. 656; Berry *v.* Alderman, 14 C. B. 95; Heath *v.* Sansom, 2 B. & Ad. 291. And in Heilbut *v.* Nevill, L. R. 4 C. P. 354, affirmed L. R. 5 C. P. 478, where a partner in fraud of the partnership, indorsed and delivered bills of exchange belonging to the firm to the defendant in satisfaction of his private debt, the defendant, who was cognizant of the fraud, having realized the bills, the assignees of the fraudulent partner, together with the other partner, without disaffirming the contract, sued the defendant for wrongful conversion. They were allowed to recover on the money counts, Baron Cleasby saying that no property passed by the indorsement and delivery of the bills by the partner for his own debt, the indorsee being cognizant of the fraud.

[3] Hogarth *v.* Latham, L. R. 3 Q. B. D. 643.

lateral security upon discount of the partner's note;[1] nor will such verbal understanding defeat the title of an indorsee for value, although the bill, indorsed by the partner in the firm name and payable to the firm, was the partner's own property.[2] Where promissory notes, made payable to a partnership, were indorsed as collateral security by one partner to another firm, for value, the pledgees thereof, being bona fide holders for value, were entitled, whether the other partner knew of the indorsement or not, to the benefit of any mortgage or other security subsequently given to secure the payment of the notes, the first firm having become insolvent.[3] But where such paper is received after due as collateral security,[4] or where the liability of the partnership upon negotiable paper has been satisfied, an indorsee receiving the same from a partner for his individual debt,[5] are subject to equities.

§57. Notice of Misappropriation to Charge the Pledgee.—Notice of fraud, in order to charge the pledgee advancing value, in good faith, upon commercial paper, wrongfully misappropriated by a partner, with knowledge thereof, and thus defeat his claim as against the partnership, must be more than a mere suspicion of defects or knowledge of facts which might excite suspicion in the mind of a cautious man. Neglect, not amounting to fraud or bad faith, will not defeat the rights of a pledgee of such paper.[6] There must be actual knowledge, suspicion, or cause of suspicion of fraud upon the partnership in the making and negotiation of the note, to defeat his title.[7] No such knowl-

[1] Michigan Bank *v.* Eldred, 9 Wall. 544.

[2] Barrett *v.* Russell, 45 Vt. 43.

[3] Walker *v.* Lee, 15 S. C. 142.

[4] Thompson *v.* Hale, 6 Pick. 259.

[5] Dana *v.* Conant, 30 Vt. 43.

[6] Redlon *v.* Churchill, 73 Me. 146; Smith *v.* Livingston, 111 Mass. 342; Freemans' Nat. Bank *v.* Savery, 127 Ib. 79; Murray *v.* Lardner, 2 Wall. 110; Cromwell *v.* County of Sac. 96 U. S. 51; Farrell *v.* Lovett, 68 Me. 326; Kellogg *v.* Curtis, 69 Ib. 212; Hobart *v.* Penny, 70 Ib. 248.

[7] Blodgett *v.* Weed, 119 Mass. 215.

edge or suspicion of fraud arose where one of two partners delivered to a third person, a co-partner with him, in another firm, a blank draft drawn by the partner, in the name of the first firm, and the blank being filled by such partner with his own name as drawee, with the name of the other firm as drawer, in the presence of the person loaning the money, the partner indorsing the bill, the money was obtained upon the credit of the bill. The other partner who had not signed the blank draft, was obliged to pay the same, although the money was misappropriated.[1] The possession of a negotiable promissory note by the maker, after indorsement has been made in the name of the firm, is sufficient to charge a third person advancing money thereon, with notice that the indorsement was intended for the accommodation of the partner,[2] or the character of the transaction may amount to notice.[3] In such cases, the burden of proving the assent of the other partners to the use of such accommodation paper, bearing the indorsement of the firm, when its character as accommodation paper has been established, is upon the holder of such paper;[4] but the proof may be from circumstances, and not of an express and positive agreement.[5]

§58. The Recovery of the Bona Fide Indorsee for Value.—Where one member of a firm makes his own note payable to his own order and indorses thereon the name of his firm, receiving and appropriating the proceeds to his own use, the firm being duly notified is liable therefor

[1] Bank of Chemung *v.* Bradner, 44 N. Y. 680.

[2] Moynahan *v.* Hanford, 42 Mich. 329; Hendrie *v.* Berkowitz, 27 Cal. 119; Stall *v.* Catskill Bank, 18 Wend. 466; Fieldens *v.* Lahens, 9 Bosw. 445.

[3] Union Nat. Bank *v.* Underhill, 21 Hun. 278.

[4] Darling *v.* March, 22 Me. 184; Foot *v.* Sabin, 19 Johns. 154; Hendrie *v.* Berkowitz, 37 Cal. 119; Lang *v.* Waring, 17 Ala. 145; Chenowith *v.* Chamberlain, 6 B. Mon. 60; Laverty *v.* Burr, 1 Wend. 529; Mechanics Bank *v.* Livingston, 33 Barb. 458; Tutt *v.* Adams, 24 Mo. 186; Heffron *v.* Hanaford, 40 Mich. 305; Dob *v.* Helsey, 16 Johns. 34.

[5] First Nat. Bank *v.* Breeze, 39 Ia. 640; Sweetzer *v.* French, 2 Cush. 315.

to an indorsee, who, in good faith, before maturity, has given value for the note, in ignorance of any circumstances affecting its validity.[1] The same rule applies where a partner has general authority to accept bills of exchange for the firm, and a bill is accepted for more than is due from the firm, there being no fraud, the bona fide holder for value of the bill is entitled to sue the partnership upon it at all events, to the extent to which there is authority, although the additional sum be in payment of a pre-existing individual debt of the partner.[2] The like principle applies in the case of a partnership holding the acceptance of a third person, where one of the two partners indorses the same to a creditor for a debt partly due from the firm and partly from himself alone, the bona fide indorsee is entitled to recover against the firm to the extent of the debt of the firm. Recovery may be had upon a count for the consideration if not upon the bill.[3]

§59. Effect of Taking Security from Individual Partner.— Generally, where the holder of negotiable paper issued in the name of a partner receives a new security from one or more of the partners liable on the same, the remaining members of the partnership are discharged. But in cases where the holder for value of such bills or notes, by an agreement made at the time retains the principal note or other personal evidence of the debt, and reserves his right to proceed against the other partners, he may maintain an action against the latter on the debt, in the event that the new note given by the individual partner should prove insufficient.[4] Where the bond of one partner was taken

[1] Redlon *v.* Churchill, 73 Me. 146; Wilson *v.* Richards, 27 Minn. 337; Gansevoort *v.* Williams, 14 Wend. 146: Swan *v.* Steele, 7 East, 210.

[2] Ellston *v.* Deacon, L. R. 2 C. P. 20

[3] Ibid.

[4] Est. of Davis, 5 Whart. 530; Yarnell *v.* Anderson, 14 Mo. 619; Vernon *v.* Manhattan Co., 22 Wend. 183; Parker *v.* Cousins, 2 Gratt. 373; Thompson *v.* Percival, 5 B. & A. 925; Bedford *v.* Dakin, 2 Ib. 210.

at the time of making a loan to a partnership, and, as the consideration for loaning the money, the other partners are not bound thereon. The acceptance of the bond having extinguished the simple contract debt, it could no longer be treated as a collateral security.[1] A judgment recovered against two persons as partners, for money borrowed for the use of the firm, although remaining unsatisfied, constitutes a bar to an action by the same plaintiffs against a third person who is afterwards discovered to have been really interested as a partner in the business, for the purposes for which the money was borrowed.[2]

§ 60. Release of Collateral Security of Partner by Payment.—The general rule was applied that partnership property is first used in paying partnership debts, to the exclusion of the creditors of the individual partners, and that the creditors of the latter are first paid from the separate effects of the debtor before the partnership creditors can claim anything, in a case where one partner of a firm had deposited with a creditor a promissory note belonging to himself as collateral security for the payment of a particular debt of the firm owing to such creditor. The debt having been paid, the partner demanded the return of his collateral note, or of the proceeds thereof, the pledgee having in the meantime collected the note at maturity. The pledgee refused to pay over the proceeds of the note, claiming to hold them to apply upon other unadjusted claims against the partnership. The firm being solvent, the collateral note or the proceeds thereof, were ordered to be returned to the individual partner.[3] Where, however, a partnership, consisting of four persons, pledged securities for the payment of a bill of exchange, and the interests of three of the partners, after dissolution, came, by assignment, into the hands of one person, who tendered to the pledgee

[1] Bond *v.* Aitkin, 6 W. & S. 165.

[2] Kendall *v.* Hamilton, L. R. 3 C. P. D. 403, affirmed in L. R. 4 App. Cas. 504.

[3] Adams *v.* Sturgess, 55 Ill. 468.

the amount for which the securities were held, without the knowledge or consent of the other partner, the refusal of the pledgee to return the securities, and his subsequent sale thereof, upon the dishonor of the bill, for a larger sum than the amount due him, was not such a conversion as would entitle the three-fourths owner of the security to maintain an action of trover.[1]

CHAPTER VII.

COLLATERAL SECURITIES IN RELATION TO BANKS.

§61. The banker's general lien on securities.
62. His lien under contract, and as against third persons.
63. The banker's liability holding securities.
64. The rights of national banks under mortgage securities.

§ 61. THE BANKER'S GENERAL LIEN ON SECURITIES.—A banker's lien is either general or special. His general lien, arising under the usual relations of banker and customer, is upon all funds and securities held by him, for the general balance of the customer.[2] Such a general lien arises upon the maturity of a note discounted for the customer, and then held by the banker, and will extend to other commercial paper, subsequently acquired by the banker in the usual course of business with his customer, and to any commercial paper belonging to the customer, indorsed by

[1] Harper *v.* Goodsell, L. R. 5 Q. B. 422.

[2] Scott *v.* Franklin, 15 East, 428; Vanderzee *v.* Willis, 3 Bro. C. C. 21; Leonino *v.* Leonino, L. R. 10 Ch. D. 460; In re European Bank, L. R. 8 Ch. 41; In re Gen. Ass. Co. L. R. 14 Eq. 507; Bank of the Metropolis *v.* N. E. Bank, 1 How. 234; s. c. 6 Ib. 212; Dumont *v.* Fry, 13 Fed. Rep. 423.

him to the banker for the purpose of collection.[1] The rule has been applied where bills of exchange deposited as collateral security for a loan account were applied, so far as not used, to meet over-drafts on another account.[2] But such lien does not extend to money left on deposit with the banker as against an appropriation of it by the customer to a holder for value of a check, drawn against such account, and is confined to such securities and valuables of the customer as may have been placed in the custody of the banker, and upon the faith of which, either in possession or expectancy, credit has been extended by the banker.[3] And to a lien on shares of stock in the bank, and dividends accruing thereon under a clause in the charter,[4] but not to documents or securities deposited for safe custody or for some purpose foreign to the relations of banker and customer.[5]

§ 62. His Lien under Contract, and as against Third Persons.—Where funds or securities are deposited with a banker as collateral security to cover a special advance or discount, the lien of the banker thereon is limited, and is discharged upon repayment of such special advance; and a claim of a banker of a general lien for balances or on account of other loans, upon such funds or securities, is not supported, where a contract for the special appropriation thereof is established.[6] The rule applies equally to

[1] Commercial Bank *v.* Hughes, 17 Wend. 94; City Bank *v.* Armstrong, 4 Dev. 59; Muench *v.* Nat. Bank, 11 Mo. App. 144; Ford *v.* Thornton, 3 Leigh. 695; Bank *v.* Bank, 11 How. 239; Brandao *v.* Barnett, 3 C.B. 519; Scott *v.* Franklin, 15 East, 428; ex parte Pease, 1 Rose, 232; ex parte Wakefield Bank, 19 Ves. 25.

[2] In re European Bank, L. R. 8 Ch. 41.

[3] Fourth Nat. Bank *v.* City Nat. Bank, 68 Ill. 398; Russell *v.* Hadduck, 3 Gilm. 233.

[4] Hague *v.* Dandeson. 2 Ex. 741.

[5] Leese *v.* Martin, L. R. 17 Eq. 224; Brandao *v.* Barnett, 1 M. & G. 908; s. c. 12 C. & F. 787.

[6] Duncan *v.* Brennan, 83 N. Y. 487; Muench *v.* Nat. Bank, 11 Mo. App. 144; Lane *v.* Bailey, 47 Ib. 395; Neponset Bank *v.* Leland, 5 Met. 259; Grant *v.* Taylor, 35 N. Y. Supr. Ct. 338; Wyckoff *v.* Anthony, 90 N. Y. 442; Gould *v.* Farmers L. & T. Co., 23 Hun, 322; In re Boys,

stock brokers and others, who have received collateral securities for their advances under a special agreement to cover a particular transaction. They are not allowed after repayment and settlement of the special contract, to apply such securities upon a general balance or other claim.[1]

The banker's general lien attaches to all funds and securities deposited with him by his customer, as against not only his customer, but the secret equities of third parties. In the current business of a bank, the fact that an account is kept in the name of a person "as trustee" does not charge the bank with greater duties in the payment of checks thereon, which it is entitled to presume are signed in the ordinary course of business of the trust estate. The rule is otherwise, where, upon the insolvency of the trustee, the bank seeks to assert a general lien on such fund as against the beneficiaries under the trust, since the bank is chargeable with knowledge that the trustee is acting for a beneficiary. This inference arises where the word "as trustee" is used, even without naming the cestuis que trust, or as "general agent."[2] The rule is applied against the general lien of a banker in cases where no trust is disclosed if the fund or securities can be traced, whether the trustee has also money belonging to him deposited in the same bank.[3]

§ 63. The Banker's Liability, holding Securities.—Bankers, and national banks, may hold collateral

L. R. 10 Eq. 467; Latham *v.* Bank of India, L. R. 17 Eq. 205; In re European Bank, L. R. 8 Ch. 41; In re Gen. Ass. Co. L. R. 14 Eq. 507.

[1] Wyckoff *v.* Anthony, 90 N. Y. 442; McVee *v.* Gorst, L. R. 4 Eq. 315, 325.

[2] National Bank *v.* Insurance Co., 104 U. S. 54; Duncan *v.* Jaudon, 15 Wall. 165; Bailey *v.* Finch, L. R. 7 Q. B. 34; ex parte Knightston, L. R. 7 Ch. 632; Pannell *v.* Hurley, 2 Col. C. C. 241; Boodenham *v.* Hoskyns, 2 De G. M. & G. 903.

[3] Farmers' Nat. Bank *v.* King, 57 Pa. St. 502; Van Alen *v.* American Nat. Bank, 52 N. Y. 1; National Bank *v.* Insurance Co. 104 U. S. 54, 67; Knatchbull *v.* Hallett, L. R. 13 Ch. D. 696; Birt *v.* Birt, L. R. 11 Ch. D. 773 *n*; Pennell *v.* Deffell, 4 DeG. M. & G. 372, 388; Frith *v.* Cartland, 2 H. & M. 417.

securities for the performance of contracts between third parties, and such corporations are estopped to insist that the act is ultra vires, as to do so would enable them to perpetrate a fraud upon innocent persons entering upon such contracts in reliance upon the representations made.[1] But a national bank has no power, upon the deposit of collateral securities to guarantee the undertaking or obligation of the pledgor, since it has no power to loan its credit in this manner.[2] Negotiable bonds held as collateral security by a bank for loans and discounts, were stolen at a time when the pledgor was not indebted thereto. The question of negligence on the part of the bank was for a jury; if it had been negligent, the proper measure of damages was, the value of the bonds at the time they were stolen.[3] Where such bonds, pledged with a bank as collateral security, were stolen before the note for which they were given as collateral security had become due and payable, in an action upon the note, the agreement of the bank relative to the safe keeping of the bond being an independent promise, and not a condition of the promise to pay in the note, the burden of showing negligence was on the pledgor.[4] Nor will evidence merely that bonds were received by a bank for safe-keeping, and were not returned to the depositor when called for because they had been stolen with other securities, be sufficient to authorize a recovery of their value from the bank.[5]

§ 64. The Rights of National Banks under Mortgage Securities.—A national bank is permitted to enforce the collection of negotiable promissory notes by foreclosing the mortgage or deed of trust on real estate, given as

[1] Bushnell *v.* Chautauqua Nat. Bank, 10 Hun. 378.

[2] Seligman *v.* Nat. Bank, (U. S. C. C. Va.) 9 Rep. 72.

[3] Third Nat. Bank *v.* Boyd, 44 Md. 47; First Nat. Bank *v.* Ocean Nat. Bank, 48 How. Pr. 148.

[4] Winthrop Savings Bank *v.* Jackson, 67 Me. 570; Mills *v.* Gilbreth, 47 Ib. 330.

[5] Wylie *v.* Northampton Nat. Bank, 64 How. Pr. 456; otherwise, where lost by gross negligence. Bank *v.* Lent, 39 Ohio St. 105.

security thereon where such note and mortgage are held as collateral security for the payment of a present loan, notwithstanding the provisions of sections 5136 and 5137 of the National Banking Act, authorizing loans on personal property only and restricting the acquisition of real estate. In National Bank *v.* Matthews,[1] a promissory note and deed of trust were pledged as collateral security with a national bank, and the principal debt not being paid at maturity, and default having occurred in the collateral notes, the trustee was directed to sell the mortgage security. The maker of the notes filed a bill in equity, seeking to restrain the sale on the ground that the bank had violated the provisions of sections 5136 and 5137 referred to. The United States Supreme Court (Swayne, J.) in its decision, declared "the impending danger of a judgment of ouster was the check, and none other, contemplated by Congress. That has always been the punishment prescribed for the wanton violation of a charter, and it may be made to follow whenever the proper public authority shall see fit to invoke its application. A private person can not, directly, or indirectly, usurp this function of the government." The rule has been generally approved that such a conveyance is not void, but only voidable.[2]

A national bank may hold mortgage security, where the consideration is a pre-existing indebtedness, new notes being executed therefor at the time the security is delivered.[3] Where the title by mortgage or conveyance is not taken to the bank directly, the case is not within the

[1] 99 U. S. 621.

[2] Silver Lake Bank *v.* North, 4 Johns. Ch. 370; Goundie *v.* Northampton Co. 7 Pa. St. 233; Baird *v.* Bank of Washington, 11 S. & R. 411; Leazure *v.* Hillegas, 7 Ib. 320; Thornton *v.* Nat. Ex. Bank, 71 Mo. 221; First Nat. Bank *v.* Haire, 36 Ia. 443; Wood *v.* People's Nat. Bank, 83 Pa. St. 57; Orm *v.* Merchants' Nat. Bank, 16 Kan. 341; Turner *v.* National Bank, 78 Ind. 19; Bank *v.* Poiliaux, 3 Rand. 136; Wrotten *v.* Armat, 31 Gratt. 228; Runyan *v.* Coster, 14 Pet. 122; Gold Mining Co. *v.* Nat. Banking Co., 96 U. S. 640; Nat. Bank *v.* Mears, 8 Biss. 158; Nat. Bank *v.* Rowell, 2 Dill. 371.

[3] Howard Nat. Bank *v.* Loomis, 51 Vt. 349.

statute, the fact that the title may enure indirectly to the security and benefit of the bank not vitiating the transaction.[1]

CHAPTER VIII.

MISAPPROPRIATION OF NEGOTIABLE INSTRUMENTS IN PLEDGE.

§65. The title of the pledgee, under misappropriation of negotiable instruments.
66. Misappropriation of blank acceptances and of accommodation paper.
67. Or where pledgor has temporary possession of pledged securities.
68. The pledge of forged collateral securities, and illegal pledges.
69. Pledge of misappropriated, lost or stolen securities after maturity.
70. Misappropriation of negotiable securities by agents.
71. Wrongful pledges by agent, for antecedent debt.
72. The rule, as applied to bankers.
73. The rule, as applied to executors and administrators.
74. And to directors of corporations.
75. What notice of defects, etc., will defeat the title of the pledgee.
76. Notice by the terms of the collateral securities.
77. Cases where notice was not presumed.
78. Recovery of the pledgee limited to advances.

§ 65. The Title of the Pledgee under Misappropriation of Negotiable Instruments.—The use of negotiable instruments, as bills of exchange or promissory notes, for the purposes of collateral security, indorsed where required, or indorsed in blank, or payable to bearer, is, under the general commercial law, so highly favored, that the pledgee thereof receiving such negotiable collateral securities before maturity, in good faith, and without notice of equity, is a holder for value, and protected, al-

[1] First Nat. Bank *v.* Haire, 36 Ia. 443.

though the act of pledge by the person entrusted with the title and apparent absolute ownership thereof is a fraud upon the real owner, and made without authority. The pledgee's title, having acted in good faith, and without notice, and given value upon the credit of such apparent absolute ownership, cannot be impeached. He enjoys the benefit of the presumption the law makes in favor of the holders of negotiable instruments, that the pledgor is the owner thereof, by a transfer for value, in good faith.[1] The protection thus afforded the pledgee of negotiable collateral securities, receiving the same before maturity, for value, and without notice of equities, is extended to cases of pledge of such collateral securities where they have been received from one who has stolen or found the same. The pledgee, receiving such negotiable instruments in good faith and without notice is a holder for value; and only bad faith, which is never presumed, can defeat his title.[2]

[1] Swift *v.* Tyson, 16 Pet. 1; Goodman *v.* Simonds, 20 How. 343; Merchants' Bank *v.* State Bank, 10 Wall, 604; Hotchkiss *v.* Nat. Bank, 21 Ib. 354; Railroad Co. *v.* National Bank, 102 U. S. 16; Swift *v.* Smith, 102 U. S. 442; Brush *v.* Scribner, 11 Conn. 387; Capen's App. 28 Ib. 220; Beadle *v.* Southern Bank, 57 Ga. 274; Murray *v.* Beckwith, 81 Ill. 43; Morris *v.* Preston, 93 Ib. 215; Paulette *v.* Brown, 40 Mo. 52; Ringling *v.* Kohn, 4 Mo. App. 59; Greenwell *v.* Hayden, 78 Ky. 322; Gardner *v.* Gager, 1 Allen, 502; Fisher *v.* Fisher, 98 Mass. 303; Draper *v.* Sexton, 118 Ib. 429; Clement *v.* Leveritt, 12 N. H. 317; Stalker *v.* McDonald, 6 Hill, 93; Stettheimer *v.* Meyer, 33 Barb. 215; Youngs *v.* Lee, 12 N. Y. 551; Boyd *v.* Cummings, 17 Ib. 101; Spencer *v.* Ballou, 18 Ib. 327; Bank of New York *v.* Vanderhorst, 32 Ib. 553; Belmont *v.* Hoge, 35 Ib. 65; Farwell *v.* Importers Bank, 90 N. Y. 384, s. c. 47 N. Y. Supr. Ct. 409; First Nat. Bank *v.* Fowler, 36 Ohio St. 524; Nichol *v.* Bates, 10 Yerg. 429; Bancroft *v.* McKnight, 11 Rich. 63; Belden *v.* Manley, 21 Vt. 551; Goodwin *v.* Roberts, L. R. 10 Ex. 76, 337, s. c. 1 App. 476; Anon, 1 Salk. 126, cas. 5; Solomons *v.* Bank of England, 13 East, 135, n. *a*; Collins *v.* Martin, 1 B. & P. 648; Miller *v.* Race, 1 Burr, 452: Gorgier *v.* Meville, 3 B. & C. 45; Palmer *v.* Richards, 15 Jur. 41; Marston *v.* Allen, 8 M. & W. 494; Lloyd *v.* Howard, 20 L. J. Q. B. 1; Ashurst *v.* Bank, 37 E. L. & E. 195.

[2] Hotchkiss *v.* National Bank, 21 Wall. 354; Greenwall *v.* Hayden, 78 Ky. 322; Raphael *v.* Bank of England, 17 C. B. 161.

§ 66. Misappropriation of Blank Acceptances and Accommodation Paper.—A holder for value of bills of exchange, before maturity, without notice of equities, in the usual course of business, is protected, although the act of pledge be a fraud and misappropriation of such paper by a person who has been entrusted, with mistaken confidence, with a blank acceptance. The rule of estoppel in pais is applied in favor of the pledgee that where a man signs his name to a blank piece of paper, and delivers it to another to be negotiated, the latter has the right to fill it up, treating the signature as that of an acceptor, and if the bill thus completed is indorsed to a holder for value, without notice, the latter is entitled to recover upon it as against the person who has thus signed his name, although the man to whom it was originally given may have defrauded him.[1] In England, where varying stamp duties are imposed upon such paper, a stamp must be affixed to make the document a valid instrument, and the amount which is filled in is governed by the stamp so affixed.[2] The power in this country is to insert an indefinite sum. Such sum, so in-

[1] Johnston Harv. Co. *v.* McLean, 57 Wis. 258 (15 Rep. 799); Violett *v.* Patton, 5 Cranch, 142; Goodman *v.* Simonds, 20 How. 361; Bank of Pittsburgh *v.* Neal, 22 Ib. 96; Joseph *v.* National Bank, 17 Kan. 256; Snyder *v.* Vandoren, 46 Wis. 602; Bank *v.* Spence, 9 Ala. 800; Van Duzer *v.* Howe, 21 N. Y. 501; Day *v.* Saunders, 42 Ib. 347; Bank of Chemung *v.* Bradner, 44 Ib. 680; Fullerton *v.* Sturges, 4 Ohio St. 529; Frazier *v.* Gaines, 58 Tenn. 93; Johnson *v.* Blasdell, 1 S. & M. 17; Russell *v.* Langstaffe, 2 Doug. 514 (decided in 1780); Peacock *v.* Rhodes, Ib. 633; Collis *v.* Emett, 1 H. Bl. 313; Schultz *v.* Astley, 2 Bing. N. C. 544; Cooper *v.* Meyer, 10 B. & C. 468; Foster *v.* Mackinnon, L. R., 4 C. P. 712; L & S. W. Bank *v.* Wentworth, L. R. 5 Ex. D. 96.

[2] A owing a debt of £50 to B writes to him enclosing a blank paper with a stamp sufficient to cover a bill for £100, saying "I don't know the exact amount of my debt, but fill up the enclosed for the amount, and I will honor it at three months." B in fraud of A draws a bill for £75, indorses it, and it comes into the hands of a bona fide holder for value. A is liable, notwithstanding the fraud, and absence of authority of B. Baron Pollock, in London & S. W. Bank *v.* Wentworth, L. R. 5 Ex. D. 96.

serted, as to holders for value without notice, is conclusive as against the acceptor.[1]

The title of a holder for value of an accommodation bill of exchange or promissory note, payable to bearer or indorsed in blank, receiving the same as collateral security for advances, is not affected by the fact that the party from whom it was received before maturity, committed an act of misappropriation thereby, having received the paper for other purposes. The presumption is, that the holder gave value for it, that being the object for which such accommodation paper is issued.[2] In such cases of misappropriation the pledgee, who has advanced value thereon, in good faith, before maturity, without notice of equities, is enlitled to recover the full face value thereof as against the accommodating maker, if less than the debt incurred, or to the amount of his advances where they are less than the value of the collateral securities.[3] The like rule applies to the holder of accommodation paper for value before maturity, without notice, receiving the same from a pledgee thereof, although as between the maker of the note and the payee and pledgee there may be a complete defense.[4]

§67. Or where Pledgor has Temporary Possession of Collateral Securities.—The title of a pledgee for value of collateral securities, receiving the same properly

[1] Violett *v.* Patton, 5 Cr. 142; Goodman *v.* Simonds, 20 How. 36; Bank of Pittsburgh *v.* Neal, 22 How. 96; Decatur Bank *v.* Spence, 9 Ala. 800; Fullerton *v.* Sturges, 4 Ohio St. 529; Van Duzer *v.* Howe, 21 N. Y. 531; Day *v.* Saunders, 42 Ib. 347.

[2] Collins *v.* Gilbert, 94 U. S. 753; Seybel *v.* Bank, 54 N. Y. 291; Percival *v.* Frampton, 2 Cr. M. & R. 183.

[3] Jackson *v.* First Nat. Bank, 42 N. J. L. 177; Duncan *v.* Gilbert, 29 Ib. 521; American Nat. Bank *v.* Harrison Wire Co., 11 Mo. App. 446; Stoddard *v.* Kimball, 6 Cush. 469; Fisher *v.* Fisher, 98 Mass. 303; Maitland *v.* Bank, 40 Md. 540; Williams *v.* Smith, 2 Hill, 301; Watson *v.* Cabot, Bank, 5 Sandf. 423; Case *v.* Mechanics' Banking Assn. 4 N. Y. 166; But not where wrongfully pledged for an antecedent debt. Rogers *v.* Keystone Nat. Bank, 83 Pa. St. 248.

[4] Cook *v.* Norwood, 106 Ill. 558; Gilman *v.* R. R. Co. 72 Ala. 566.

indorsed, so as to take full title thereto, is protected where the pledgor, having temporary possession of such securities, converts the same to his own use, the other person being chargeable with knowledge of the indorsement thereon. The payee of a promissory note, upon obtaining an advance, indorsed the note to the pledgee by name, as collateral security. Upon repaying a part of the loan, the pledgor was allowed to take temporarily the collateral note, thinking he could make a beneficial sale of it, upon an agreement that it should be returned and indorsed by the pledgee upon payment of the balance of his advance. The pledgor immediately negotiated the note to a third person, to whom payment of the full face thereof, upon its surrender, was made by the makers. The pledgee sued the makers, setting up the restricted indorsement to himself, but the note was not produced. The makers and purchaser were held chargeable with knowledge of the rights of the pledgee to the note, although the purchaser could not read, while no estoppel arose, as against the pledgee, from the delivery for such a purpose of a note specially indorsed. The failure to produce the note upon trial created of itself a presumption that the indorsement remained uncanceled at the time of payment by the makers.[1]

§68. The Pledge of Forged Collateral Securities, and Illegal Pledges.—A claim founded on negotiable securities arising directly out of a forgery by one of the parties thereto, is not supported.[2] Where, however, the action is to recover on collateral securities, which are independent of and not tainted with forgery, although the felonious act has entered into other parts of the transaction, the pledgee is entitled to recover. Bills of exchange, pledged to bankers to secure over-drafts, were discovered to

[1] Pier *v.* Bullis, 48 Wis. 429.

[2] Crosby *v.* Long, 12 East, 409; Wallace *v.* Hardacre, 1 Campb. 45; ex parte Ball, L. R. 10 Ch. D. 667; Wells *v.* Abrahams, L. R. 7 Q. B. 554; Wellock *v.* Constantine, 2 H. & C. 146.

be forgeries, and other genuine promissory notes of the guilty parties were given as collateral security for the same overdrafts upon a surrender of the forged bills. The pledgee was allowed to avail himself of the last securities, the agreement upon which they were received being a contract independent of the felony.[1] Where a bill of exchange was accepted in blank for the purpose of being negotiated (the blank acceptance being given on account of a loan) and was afterwards filled in with the name and signature of a person as drawer and indorser, the acceptor was not allowed, as against a bona fide indorsee for value, the bill having been deposited at a bankers who made an advance thereon equal to the full value of the bill, to introduce evidence to show that either the drawing or indorsement was a forgery, the forgery forming no part of the transaction by which the bank acquired the bill.[2]

The rights of the innocent indorsee of negotiable instruments as collateral security for debts of the transferror, receiving the same without notice of his want of authority to transfer, and in the usual course of business, is supported as against the rightful owner, even in states where the pledge or transfer, in any way, of collateral securities by the pledgee before the debt is due and payable, without the authority of the real owner, is made a statutory offense. Such assignment has been sustained in Massachusetts.[3] Nor was the pledgee put upon inquiry as to their title, by the fact that the pledgors informed the pledgee that they would probably want to substitute other collaterals for the note before its maturity.[4] A later case in the same state is to the like effect.[5]

§69. Pledges of Misappropriated, Lost or Stolen Securities, After Maturity. — The pledgee, receiving

[1] Ex parte Leslie, L. R. 20 Ch. D. 131; Murray *v.* Lardner, 2 Wall. 121.

[2] London etc. Bank *v.* Wentworth, L. R. 5 Ex. D. 96.

[3] Gen. Stats. Mass. C. 161, §64; Pub. Stats. Mass. 1882, pt. 4. tit. 1, ch. 203, §72.

[4] Gardner *v.* Gager, 1 Allen, 502.

[5] Draper *v.* Saxton, 118 Mass. 427.

negotiable instruments as collateral security, after due, although for a valuable consideration, is subject to the antecedent equities and defenses in common with other holders of dishonored paper.[1] The rule applies in cases where such negotiable paper is pledged after its maturity by a person who is not its owner, nor authorized to pledge, but misappropriates the same. The pledgee in such cases acquires no title or right to such collaterals as against the defrauded owner.[2] Nor will the doctrine of estoppel, founded upon the acknowledged equitable rule that where one of two innocent purchasers must suffer, the loss should fall upon the one who has enabled the third person to commit the fraud, be applied for the relief of the pledgee in cases where the possession given by the owner to the pledgor is for the legitimate purpose of making collection of the collaterals, and with no power to pledge, or in other like cases. A pledge made under such circumstances after the maturity of the paper, vests in the pledgee no greater rights than those of the pledgor himself.[3]

The rule that the pledgee of negotiable securities, receiving them after maturity, is subject to antecedent equities, is applied where such securities have been lost by the owner, or stolen from him. Where negotiable coupons were stolen from the owner before their maturity, and passed by several transfers into the hands of the defendant in good faith, for value, no presumption arising that the thief had negotiated the coupons before maturity, the defendant was therefore subject to all antecedent rights, aud to all defenses of the

[1] Murray *v.* Lardner, 2 Wall. 118; Foley *v.* Smith, 6 Ib. 493; Texas *v.* White, 7 Ib. 735; Arents *v.* Commonwealth, 18 Gratt. 750; Ashurst *v.* Bank, 37 E. L. & E. 195.

[2] Parsons *v.* Jackson, 99 U. S. 440; Vermilye *v.* Adams, 21 Wall. 143; Texas *v.* White, 7 Ib. 700; Texas *v.* Hardenbergh, 10 Ib. 90; Fowler *v.* Brantley, 14 Pet. 318; Andrews *v.* Pound, 13 Ib. 65; Henderson *v.* Case, 31 La. Ann. 215; Davis *v.* Bradley, 26 Ib. 555; Stern *v.* Germania Bank, 34 La. Ann. 1119.

[3] Foley *v.* Smith, 6 Wall. 493; Bird *v.* Cockrem, 28 La. Ann. 70; Stern *v.* Germania Bank, 34 La. Ann. 1119.

promisor.[1] The like rule was applied in a case where a negotiable coupon bond was pledged by a third person, who had obtained possession of the same by a felonious act, the bond at the time of the pledge being over-due five years, although continued payments of interest had been made thereon.[2]

But where bills of exchange were received by a creditor from his debtor as collateral security for the payment of a debt which had been contracted under circumstances which might render the debtor liable to a criminal proceeding, it was not enough to show in defense of an action on the collaterals, that the creditor was thereby induced to abstain from prosecuting the maker.[3] Equity will not aid either party where the consideration is illegal.[4]

§70. Misappropriation of Negotiable Securities by Agents.—The innocent indorsee of negotiable instruments as collateral security, for a valuable advance, before maturity and without notice, although the act of pledge be a misappropriation by an agent intrusted with possession and the apparent absolute ownership thereof, is protected, as a holder for value, in the usual course of business.[5] In a case where negotiable instruments were fraudulently misappropriated as collateral security by an agent, for a bona fide advance to himself, the United States Supreme Court say: "Although the pledgee took the note only as collateral security, he is entitled to the protection of a purchaser for value, without notice of anything to impeach his right.

[1] Hinckley *v.* Merchants' Nat. Bank, 131 Mass. 147.

[2] Greenwall *v.* Hayden, 78 Ky. 332.

[3] Flower *v.* Sadler, L. R. 9 Q.B.D. 83; Ward *v.* Floyd, 7 Scott (N.S.) 499.

[4] Taylor *v.* Chester, L. R., 4 Q. B. 309.

[5] Railroad Co. *v.* National Bank, 102 U. S. 16; Belmont Bank *v.* Hoge, 35 N. Y. 65; Clement *v.* Leverett, 12 N. H. 317; Murray *v.* Beckwith, 81 Ill. 43; Chicopee Bank *v.* Chapin, 8 Met. 40; First Nat. Bank *v.* Fowler, 36 Ohio St. 524; Goodman *v.* Simonds, 20 How. 343; Swift *v.* Smith, 102 U. S. 442; Stone *v.* Brown, 54 Tex. 330. See Wickham *v.* Morehouse, 16 Fed. Rep. 324.

Conceding that the agent was not in fact the owner of the note when he transferred it, and that in transferring it, he perpetrated a fraud upon the true owner, it is still certain that he was clothed with power to make the transfer, and though its exercise was a fraud, if the pledgee advanced his money in good faith relying upon the apparent ownership, the true owner thereby lost his title. He was bound by the act of his agent or attorney."[1] The pledgee, as a holder for value, is entitled to recover the full amount of such misappropriated securities from the parties liable thereon,[2] but where the suit is against the defrauded party, and the debt secured is less than the face of the note, and the pledgee is not responsible over to any third person for any surplus remaining in his hands after the payment of his debt, his recovery is limited to the amount of his claim, or to so much thereof as remains unpaid.[3]

The leading English case of Goodwin *v.* Roberts[4] fully supports the rights of the pledgee for value of negotiable securities, when taken in good faith, without notice of equities, although the act of pledge is a misappropriation thereof by an agent. The negotiable securities in that case were left with a stock-broker, as agent of the owner, to be disposed of as the owner might direct, but the agent wrongfully pledged the same, with other negotiable instruments, as collateral security for an advance from a bank, and afterwards became bankrupt. The bank sold the collaterals on the stock exchange, according to the usual custom, applying the proceeds to the payment of the debt, having no notice of the claims of the owner during the whole transaction.

[1] Swift *v.* Smith, 102 U. S. 442. The same rule was enforced in Railroad Co. *v.* Nat. Bank, 102 U. S. 14, where a broker, entrusted with negotiable notes, indorsed in blank, for sale, fraudulently pledged them for his own antecedent debt. The pledgee, receiving them without notice, was allowed to collect the whole face of the note from the defrauded maker.

[2] Stoddard *v.* Kimball, 6 Cush. 469; Chicopee Bank *v.* Chapin, 8 Met. 40; Swift *v.* Smith, supra; Watson *v.* Russell, 3 B. &. S. 34, 40.

[3] Chicopee Bank *v.* Chapin, supra.

[4] L. R. 10 Ex. 76; s. c. Ib. 339; on app. L. R. 1 App. 476.

The delivery of a government bond payable to bearer, by an agent, as collateral security for his own debt, notwithstanding he held the same simply to collect interest thereon, the pledgee receiving the same in good faith, without notice, was sustained as against an action of trover by the owner.[1]

§71. Wrongful Pledge by Agent, for Antecedent Debt.—In states, including New York and Pennsylvania, where the rule prevails that the indorsee of negotiable instruments, receiving the same, as collateral security for an antecedent debt, without further consideration, is not a holder for value, in the usual course of business, the pledgee, so receiving such securities from an agent, where the act is one of misappropriation, although without knowledge thereof, is not entitled to recover. The question of misappropriation by agents arose in the leading cases of Coddington *v.* Bay[2] and Stalker *v.* McDonald[3] and other cases in New York follow the ruling in those cases.[4] The like rule was enforced in Pennsylvania.[5]

§72. The Rule as applied to Bankers.—Protection is also afforded the bona fide pledgee of negotiable securities in cases where the wrongful misappropriation thereof is the act of bankers or banking corporations, holding such negotiable instruments with full title. Where, by reason of misplaced confidence, a banker is entrusted with possession of such evidences of title as negotiable promissory notes, indorsed in blank, although the purpose simply be that he may collect accruing interest thereon, and the banker deposits the notes, with other securities, with his correspondents, as collateral security for present indebtedness and for future advances, the real owner is not allowed,

[1] Gorgier *v.* Mieville, 3 B. & C. 45.
[2] 5 Johns. 54; s. c. 20 Ib. 637.
[3] 6 Hill, 93.
[4] Scott *v.* Betts, Hill & D. 363; Francia *v.* Joseph, 3 Edw. Ch. 182.
[5] Petrie *v.* Clark, 11 S. & R. 379; Royer *v.* Keystone National Bank, 83 Pa. St. 248.

in an action of replevin, brought after the country banker has become insolvent, to recover possession of the notes so pledged from the indorsee holding them in good faith, for value in the usual course of business, as collateral security.[1] A banker, with whom negotiable bills have been deposited, making an indorsement thereof as collateral security for a loan to himself, the property in such bills, to the extent at least of the advances, passes to the bona fide indorsee as against the real owner.[2] And a pledge of such negotiable paper, entrusted to a bank director as an individual, for the purpose of getting the same discounted for the benefit of the owner, to the bank of which he is a director, for his own past debt and a present advance, was supported as against the real owner, the bank not being chargeable with notice of the real transaction, as the director was not acting in his official capacity in obtaining the loan.[3]

The pledge of negotiable instruments by a bank, holding them on deposit for safe keeping, for the purpose of securing the re-payment of a loan to itself, vests in the pledgees a title thereto good as against all the world, to hold and dispose of them according to the terms of the contract of pledge. Such title can not be divested by a "dishonest trick," nor by the fact that the pledgor recovered possession by an act of gross fraud or violence.[4] And where the managing cashier of a bank has been authorized by the directors thereof to transfer to another bank as collateral security for

[1] Morris *v.* Preston, 93 Ill. 215.

[2] Collins *v.* Martin, 1 B. & P. 648; Treuttell *v.* Barandon, 8 Taunt. 100.

[3] Washington Bank *v.* Lewis, 22 Pick. 24. In Bank *v.* Hemingray, 34 Ohio St. 381, a banker induced a firm to continue its deposit by positively holding himself out as still the holder of several negotiable notes made to him by the principal members of the firm, when in fact he had assigned them as collateral security for a debt. There was an understanding that the notes of the partners were to be paid through the deposit account of the firm. The banker became bankrupt. After satisfying the debt for which the notes of the individual members were held as security, the latter, as against the assignee in bankruptcy, was entitled in equity to set off the firm account against the balance on the notes.

[4] Ringling *v.* Kohn, 4 Mo. App. 59.

a loan, notes and bills discounted by the borrowing bank, and a loan was made in good faith, the right of the pledgee to recover was not affected by the fact that the cashier of the borrowing bank gave a note, signed by himself individually, and payable to himself as cashier, for the amount of the loan, if in fact the application was for a loan to his bank, and on its credit, and the loan was in good faith so made. The fact that the cashier misapplied the money to his own private purposes was held not to affect the validity of the contract, nor to prevent the pledgee from collecting the securities, and retaining enough to repay its advances.[1]

§ 73. The Rule as applied to Executors and Administrators.—Generally, an executor may dispose of the personal estate, including negotiable securities, of the testator by sale or pledge, in connection with the management of the estate, and even where the sale or pledge of such securities is made for other purposes, of which the person advancing money has no knowledge or notice, but receives the same, in good faith, for value, the transaction is sustained, for the pledgee is not bound to see to the disposition of the loan.[2] The rule is otherwise where the pledgee is chargeable with knowledge that such disposition of the assets of the estate, is a perversion, or that the proceeds are to be used for purposes other than the benefit thereof. Property thus acquired from an executor may be followed and recovered.[3] The pledgee will

[1] City Bank *v.* Perkins, 4 Bosw. 420.

[2] Smith *v.* Ayer, 102 U. S. 320. Russell *v.* Place, 18 Beav. 21. The rule applied to trustees: Loring *v.* Brodie, 134 Mass. 453; Learned *v.* Tritch, 6 Col. 432; White *v.* Fulton, 68 Ga. 511; Ex parte Williams, 18 S. C. 299.

[3] Colt *v.* Lasmer, 9 Cow. 320; Field *v.* Schieffelein, 7 Johns. Ch. 150; Petrie *v.* Clark, 11 S. & R. 377; Thomasson *v.* Brown, 43 Ind. 203; Smith *v.* Ayer, supra; Walker *v.* Taylor, 4 L. T. N. S. 845; Miller *v.* Williamson, 5 Md. 219. The rule applied to trustees: Ham *v.* Ham, 58 N. H. 177; Shuey *v.* Latta, 90 Ind. 136; Holden *v.* Upton, 134 Mass. 177; Head *v.* Bridges, 67 Ga. 227; Dodge *v.* Meyer, 94 N. Y. 209; Sheetz *v.* Neagley, 13 Phila 506; May *v.* Le Claire, 11 Wall. 235; Dows *v.* Berry, 18 Fed. R. 121; Mitchell *v.* Coburn, 61 Md. 244.

be ordered to return the collateral securities thus wrongfully pledged by an executor, where he has received them with knowledge and connivance.[1] An order to this effect was entered by Lord Thurlow in a case where bonds had been wrongfully pledged by an executrix for a personal debt, the pledgee having notice of the misappropriation. If converted into cash, the pledgee is liable for the full value thereof,[2] and money loaned by one executor to the other, upon his individual note, upon representations that it is to be used in paying the debts of the estate, but is not so used, is not a proper charge against the estate.[3] Where an administrator improperly pledged negotiable notes of the estate, and the notes or their proceeds passed into the hands of one chargeable with knowledge of the true ownership thereof, no estoppel arose to prevent such administrator from recovering such notes or their proceeds from such persons.[4]

§ 74. And to Directors of Corporations.—The pledge of bonds or other securities of a corporation by the officers thereof to themselves, or to some of their number, is required to be made in good faith, the tendency being to scrutinize such transactions closely and rigorously. Where a pledge of such bonds is made by the officers and directors of a railroad company to each other to secure an indebtedness of less than four per cent. of the face of the bonds, the transaction on its face is nothing less than an actual fraud upon the corporation and its stockholders.[5] But there is no reason why a director, or officer of a corporation, may not receive the negotiable bonds or other securities thereof as collateral security, where a debt is honestly due him, or he has incurred a liability, or advanced money thereon. Notwithstanding the trust relations existing be-

[1] Smith *v.* Ayer, 102 U. S. 320.
[2] Scott *v.* Tyler, 2 Dick. 724.
[3] Croft *v.* Williams, 88 N. Y. 384.
[4] State *v.* Berning, 74 Mo. 87.
[5] Chouteau *v.* Allen, 70 Mo. 290, 336; Wilbur *v.* Lynde, 49 Cal. 290.

tween such officials and the company, a pledgee, so receiving collateral security from a company of which he is an officer, is entitled to hold the same until payment of the loans.[1]

§ 75. What Notice of Defects, etc., will Defeat the Title of the Pledgee.—The knowledge or degree of negligence, on the part of one claiming to be a bona fide pledgee of negotiable paper, of defects in the same, or of the misappropriation thereof, or of the pledgor's want of title thereto, sufficient to defeat the claims of such pledgee, must be something more than a mere suspicion of defect of title, or a knowledge of circumstances which would excite suspicion in the mind of a prudent man, or even gross negligence. Bad faith or fraud are the only grounds upon which the title of the pledgee can be overthrown. The burden of proof lies on the person who assails the right claimed by the party in possession.[2] Every one must conduct himself honestly in respect to the antecedent parties, when he takes negotiable paper, in order to acquire a title, which will shield him against prior equities. Although not obliged to make inquiries, the pledgee must not wilfully avoid the means of knowledge which he knows are available,

[1] Duncombe *v.* Railroad Co., 84 N. Y. 190; s. c. 88 Ib 1; Twinlick Oil Co. *v.* Marburg, 91 U. S. 587.

[2] Bank of Pittsburgh *v.* Neal, 22 How. 96; Calais Steamboat Co *v.* Van Pelt, 2 Black 377; Murray *v.* Lardner, 2 Wall. 100; Hotchkiss *v.* Nat. Banks, 21 Ib. 354, 359; Smith *v.* Ayer, 101 U. S. 320; Swift *v.* Smith, 102 Ib. 442; Railroad Co. *v.* Sprague, 103 U. S. 756, 763; Wickham *v.* Morehouse, 16 Fed. Rep. 324; Welch *v.* Sage, 47 N. Y. 143; Miller *v.* Williams, 5 Md. 219; Worcester Bank *v.* Dorchester Bank, 10 Cush 491; Ashton *v.* Taylor, 3 Allen 217; Sturtevant *v.* Jaques, 14 Ib. 523; Spooner *v.* Holmes, 102 Mass. 503; Nat. Bank *v.* Savery, 127 Ib. 79; Treuttel *v.* Barandon, 8 Taunt. 100; Sigourney *v.* Lloyd, 8 Barn. & C. 622; s. c. 5 Bing. 525. In Murray *v.* Lardner, 2 Wall. 121, a bona fide purchase for value of a negotiable bond, in the usual course of business, was supported, although the bond in fact had been stolen from the true owner.

since such conduct, whether equivalent to notice or not, would be plenary evidence of bad faith.[1]

The rule was announced in the case of Gill *v.* Cubitt[2] that the title of a holder of negotiable securities, although paying full value, would not be supported, because received under circumstances which "ought to have excited the suspicion of a prudent and careful man." The rule was questioned[3] and finally overruled in Goodman *v.* Harvey.[4] In New York, the influence of Gill *v.* Cubitt led to decisions that where a negotiable security was received as payment of an antecedent debt, without notice of equities, the creditor was not a holder for value, in the usual course of business;[5] and that if a party in good faith took a negotiable security of a holder without due inquiry, or with knowledge of such facts or circumstances as would put a prudent man upon inquiry in making purchases of personal property, he would not acquire a good title to the instrument, if it appeared that equities in fact existed between the antecedent parties, and that vigilant inquiry would have enabled the taker to

[1] Goodman *v.* Simonds, 20 How. 343, 346; May *v.* Chapman, 16 M. & W. 355.

[2] 3 B & C. 466.

[3] Crook *v.* Jadis, 3 B. & C. 456; Backhouse *v.* Harrison, 5 B. & A. 1098.

[4] 4 Ad. & E. 870. Lord Denman, in delivering judgment, said: "We are all of opinion that gross negligence only would not be a sufficient answer, where a party has given consideration for a bill; gross negligence may be evidence of mala fides, but it is not the same thing. Where the bill has passed to the plaintiff without any proof of bad faith in him, there is no objection to his title." Dutchess Ins. Co. *v.* Hachfield, 73 N. Y. 226; Seybel *v.* Nat. Currency Bank, 54 Ib. 288, 295; Welch *v.* Sage, 47 N. Y. 143; Pringle *v.* Phillips, 5 Sandf. 157; Goodman *v.* Simonds, 20 How. 343, 364; Bank *v.* Neal, 22 Ib. 96; Murray *v.* Lardner, 2 Wall. 110; op. of Mr. Justice Clifford, Railroad Company *v.* Nat. Bank, 102 U. S. 14, 39, 42; Collins *v.* Gilbert, 94 Ib. 753; Swift *v.* Smith, 102 U. S. 442; Uther *v.* Rich, 10 Ad. & E. 784; Stephens *v.* Foster, 1 C. M. & W. 849; Arbouin *v.* Anderson, 1 A. & E. N. S. 498; May *v.* Chapman, 16 M. & W. 355; Raphael *v.* Bank, 17 C. B. 161; Bank *v.* Leighton, 2 Ex. 61.

[5] Bank of St. Albans *v.* Gilliland, 23 Wend. 311; Small *v.* Smith, 1 Denio, 583.

have ascertained the true character of those equities, but this "legal heresy"[1] has also been abandoned.[2]

§76. Notice by the Terms of the Collateral Security.—Where the negotiable instrument offered as collateral security for an advance to the person presenting the same, shows upon its face the existence of a trust, or that the person offering it is not the absolute owner thereof, but holds it in some fiduciary character, or that it belongs to some other person, the pledgee is presumed to know the true owner, and is thus chargeable with knowledge, and can acquire no title as against the defrauded cestuis que trust or real owner. Holding under such circumstances, the pledgee is not a holder for value in good faith, in the usual course of business. What will be notice sufficient under this rule to charge the pledgee so as to defeat his title, is a question of construction, and is usually determined by the court as a matter of law.[3] Every person is presumed to know the con-

[1] Railroad Co. *v.* Nat. Bank, 102 U. S. 14, 41, by Mr. Justice Clifford.

[2] Pringle *v.* Pringle, 5 Sandf. 157; Welch *v.* Sage, 47 N. Y. 143, 147; Seybel *v.* Nat. Currency Bank, 54 Ib. 288, 295; Dutchess Ins. Co. *v.* Hachfield, 73 Ib. 226.

[3] Andrews *v.* Pond, 13 Pet. 65; Fowler *v.* Brantley, 14 Ib. 318; Collins *v.* Gilbert, 94 U. S. 753, 758; Swift *v.* Smith, 102 U. S. 442; Goodman *v.* Simonds, 20 How. 243; Brown *v.* Davis, 3 T. R. 86; Nat. Security Bank *v.* McDonald, 127 Mass. 82; Nat. Bank *v.* Savery, Ib. 78; In Strong *v.* Jackson, 123 Mass. 60, 63, a case of wrongful misappropriation of negotiable instruments as collateral security, the Court say: "Upon an examination of the cases, it will be found that it is very rarely decided that any one fact is or is not conclusive evidence of notice. Indeed, in the nature of things, it can scarcely happen that the question is to be decided upon an isolated fact. It may be that in a particular case some single fact in and of itself is sufficient, but generally it is not so. The question is ordinarily a broader one; it is this: Do all the facts, taken in connection with the subject matter, with the situation and relation of the parties, their means of knowledge, the circumstances which should lead to inquiry, together show such a state of facts that it would be inequitable for subsequently acquired rights to supplant rights previously acquired? In this view, a fact, which under some circumstances and some situations and relations of the parties would be insignificant, in other relations of the parties and under other circumstances would be decisive; and thus many apparently conflicting decisions will be found harmonious."

tents and meaning of written instruments, and the construction given to commercial paper at the time of its transfer, and of the order of the names upon it.[1] Pledgees advancing upon negotiable instruments showing upon their face, or by indorsement, that they are already held as collateral security, as where an indorsement recited, "This note is held by me for note signed by X," etc., are chargeable with notice as to the limited interest of the pledgor.[2] Where bills are indorsed to an agent of the owner "for their account," a pledgee thereof receiving them as collateral security for past and future advances to the agent, is chargeable with notice, and can take no title to the securities as against the real owner.[3] The words "as trustees," in the case of a pledge of securities for a greater sum than authorized, is sufficient to put the pledgees upon inquiry as to the extent of the authority of the pledgor when asking an advance for his own benefit.[4]

§77. Cases Where Notice was not Presumed.—A negotiable promissory note, marked upon the margin "This note secured by trust deed of even date herewith," was received as collateral security. No notice of any claims of third parties was chargeable to the pledgee from such a notation.[5] Promissory notes, worded "I promise to pay to A., as he is the trustee under the will of B., deceased, or order," were pledged as collateral notes to secure the payment of a personal note of the trustee, discounted by a bank, the money being for his own use, the bank having previously refused to discount the notes afterwards accepted as collateral security. No notice was charged as against the pledgee by reason of the wording of the notes that the trustee was

[1] Swift *v.* Smith, 102 U. S. 442.

[2] National Security Bank *v.* McDonald, 127 Mass. 82; National Bank *v.* Savery, Ib. 78.

[3] Treuttel *v.* Barandon, 8 Taunt. 100.

[4] Swan *v.* Produce Bank, 24 Hun, 277.

[5] Swift *v.* Smith, 102 U. S. 442.

acting in violation of his duty.[1] And a mere indorsement of a note as "curator," is not sufficient to charge a pledgee advancing money in good faith to the holder, although in fact the pledge be a misappropriation.[2] A promissory note, containing the words "I promise to pay to the order of myself," and executed by two persons, having been handed by one to the other, who misappropriated the same as collateral security for a precedent debt, the title of the pledgee was not affected by any notice or knowledge presumed from the fact that only one name was indorsed.[3] If a negotiable instrument indorsed in blank is placed in the hands of an agent for safe-keeping, and the agent fraudulently appropriates and pledges the same before maturity, an innocent pledgee advancing money on such paper, without notice of equities, is a holder for value, and protected, as there is nothing in the fact of the pledge of such securities by persons having an absolute title, to put a pledgee upon inquiry.[4]

§78. Recovery of the Pledgee Limited to Advance.—The pledgee of negotiable instruments holding the same bona fide and for value, is entitled to recover from the parties the full face value of the same, holding any balance, where the collateral notes are greater in amount than the principal debt, for the use of the parties beneficially interested. Where, however, the pledge of such instruments has been fraudulently made by persons intrusted with the legal title, the pledgee, receiving the same in good faith, and for value, and without notice of the fraud, although entitled to recover the full amount as against the parties liable upon the securities, if necessary to reimburse himself for his advances made on the faith and credit of such title, is generally subject to the equitable rule that, as against the

[1] Ashton *v.* Taylor, 3 Allen, 217.

[2] Paulette *v.* Brown, 40 Mo. 52.

[3] First Nat. Bank, *v.* Fowler, 36 Ohio St. 524.

[4] Stone *v.* Brown, 54 Tex. 330.

party defrauded he is allowed to recover only the amount of his loans. In such cases of misappropriation, the pledgee is under no liability as to any possible surplus to the pledgor by whose fraud the paper was misappropriated.[1] The like rule was applied in the case of a misappropriation by a trustee of a promissory note belonging to the trust fund, where the same was taken as collateral security for a debt less than the face of the note, the cestuis que trust being allowed to redeem upon paying the amount of the debt.[2]

[1] Dresser *v.* Missouri R. R. Co., 93 U.S. 92; Hotchkiss *v.* Nat. Banks, 22 Wall. 354; Morris *v.* Preston, 93 Ill. 215; Greenwall *v.* Hayden, 78 Ky. 322; Williams *v.* Smith, 2 Hill, 301; Watson *v.* Cabot Bank, 5 Sandf. Ch. 423; Case *v.* Banking Assn. 4 N. Y. 166; City Bank *v.* Perkins, 4 Bosw. 420; Duncombe *v.* Railroad Co., 84 N. Y. 190; Allaire *v.* Hartshorne, 21 N. J. L. 663; Duncan *v.* Gilbert, 29 Ib. 521; Jackson *v.* First Nat. Bank, 42 N. J. L. 177; Stoddard *v.* Kimball, 6 Cush. 469; Fisher *v.* Fisher, 98 Mass. 303; Chicopee Bank *v.* Chapin, 8 Met. 40; Maitland *v.* Bank, 40 Md. 540; Belden *v.* Manley, 21 Vt. 551; Collins *v.* Martin, 1 B. & P. 648; Treuttel *v.* Barandon, 8 Taunt. 100.

[2] Belden *v.* Manley, 21 Vt. 551.

CHAPTER IX.

TRANSFER AND SUB-PLEDGE OF COLLATERAL SECURITIES.

§79. The pledgee's transfer of negotiable securities.
80. The sub-pledge of such collateral securities.
81. Estoppel of pledgor, where pledgee has title and ownership—the sub-pledgee a holder for value.
82. Distinction between sub-pledges of negotiable collateral securities and others non-negotiable.
83. Sub-pledges for sums larger than original advance.
84. Discharge of the sub-pledgee.

§79. The Pledgee's Right to Transfer Negotiable Collateral Securities.—The pledgee of negotiable instruments, receiving the same properly indorsed, where required, so as to be vested with the full title thereto, may, in the absence of statutory restriction or special agreement, assign or transfer his principal claim against the pledgor, with the collateral security given to secure its payment. The pledgor, in such cases, has no cause of complaint, so long as he is not deprived of his right to redeem such collateral securities upon payment of his debt.[1] The assignment may be of all the pledgee's interest in the collateral notes, or they may be assigned conditionally to secure payment of his own debt, or they may be delivered up to a bailee without consideration. Transfer of the principal and collateral notes in either of these ways is a legal disposition of them,

[1] Chapman *v.* Brooks, 31 N. Y. 75; Hays *v.* Riddle, 1 Sandf. 248; Duncombe *v.* N. Y. R. Co. 84 N. Y. 190, 201; s. c. 88 Ib. 1; Lewis *v.* Mott, 36 N. Y. 395; Gould *v.* Farmers' Loan & Trust Co., 23 Hun, 322; Baldwin *v.* Ely, 9 How. (U. S.) 580, 601; Fennell *v.* McGowan, 58 Miss. 261; White Mountain R. R. *v.* Bay City Iron Co., 50 N. H. 57; Merchants Bank *v.* State Bank, 10 Wall. 604.

authorized by the holder's interest as pledgee.[1] The securities pledged for a debt follow it, in equity, no matter how the debt be modified, or into whose hands it may come. Until the debt is paid, the pledge accompanies it, and remains for its repayment, and is available to all who may acquire title thereto.[2]

Where a pledgee sells or assigns collateral securities, retaining the note or bill evidencing the original debt, and retains possession until after maturity thereof, tender or payment to the indorsee of collateral notes operates as a discharge of the original note. Any action brought thereafter upon the note, either by the pledgee or by any indorsee thereof, taking the same after maturity, may be successfully defended by showing payment or tender by the pledgor to the holder of the collateral notes. The pledgor may also, after making such tender, file a bill in equity, making the pledgee and the holder of the collateral securities parties, and thus settle the rights of all interested.[3] Where such negotiable collateral securities are wrongfully assigned to a third person, without authority of the debtor, the pledgee may be charged with the face value thereof in payment of the principal debt.[4]

Equity will refuse to sustain an unjust and unconscion-

[1] Goss *v.* Emerson, 23 N. H. 38.

[2] Stearns *v.* Bates, 46 Conn. 313; Jones *v.* Quinnipack Bank, 29 Ib. 25; Lewis *v.* DeForest, 20 Ib. 427; Belcher *v.* Hartford Bank, 15 Ib. 383.

[3] Talty *v.* Freedman's etc. Co , 93 U. S. 321. In Donald *v.* Suckling, L. R. 1 Q. B. 585, 611, debentures, non-negotiable, had been pledged as collateral for the payment of a bill of of exchange, with power of sale. The collateral securities were sub-pledged by the pledgee. The plea failed to state whether the sub-pledge of the collateral securities was made after the maturity of the bill of exchange, but, as against the defendant in whose knowledge the matter lay, it must be taken as before the time the bill was dishonored, and consequently at a time when the first pledgee was not yet entitled, by virtue of his contract with the pledgor, to dispose of the collateral securities.

[4] Hawks *v.* Hincliff, 17 Barb. 492. The like rule is applied under the Louisiana Code, where the pledgee holding a note, or other collectible instrument, sub-pledges the same. He is chargeable with the full amount of the security, unless he can show that it was worth less than its face value. Laloire *v.* Wiltz, 29 La. Ann. 329.

able agreement between the pledgor and pledgee and third parties, whereby, upon default, the collateral securities are absolutely forfeited, and under which upon default after a sale of the collaterals realizing more than enough to pay the debt, an action is brought upon the principal note.[1]

§80. The Sub-Pledge of such Collateral Securities.—The pledgee of negotiable instruments may sub-pledge such collateral securities to secure the re-payment of an advance made bona fide by a third person to himself.[2] By a sub-pledge of such negotiable securities, a pledgee holding the legal title and the apparent absolute ownership thereof, may transfer to a sub-pledgee, receiving the same bona fide, for a valuable advance before maturity and without notice of equities, upon the faith of such title and possession, a more extended right over such negotiable instruments held as collateral security than he himself possesses under the original contract of pledge, although such sub-pledge in fact be a tortious act.[3] Nor is the sub-pledge of

[1] Dorrill *v.* Eaton, 35 Mich. 302.

[2] Ex parte Sergant, L. R., 17 Eq. 279 (Jessell, M. R.), speaking of a mortgage or pledge with legal title of securities, "Like every other mortgagee, he had a right to re-borrow and to transfer his security." Langton *v.* Waite, L. R. 6 Eq. 165. The court (Malins, V. C.): "It is a right which the lender of money upon any security would have." To like effect, France *v.* Clark, L. R. 22 Ch. D. 830; Merchants' Bank *v.* State Bank, 10 Wall. 604.

[3] Jarvis *v.* Rogers, 13 Mass. 105; s. c. 15 Ib. 389, 417; Briggs *v.* Rice, 130 Ib. 50; Gould *v.* Farmers' Loan and Trust Co., 23 Hun, 322. In Draper *v.* Saxton, 118 Mass. 427, the amount of recovery which might be had by the sub-pledgee of negotiable instruments did not arise as the sub-pledge was made for a less sum than the amount of the original pledge. In Jarvis *v.* Rogers, supra, Jarvis, the intestate, was considerably indebted to one Russell, who held in his possession certain negotiable scrip, indorsed in blank by Jarvis, and subsequently made a definite loan of $500 thereon. Russell afterwards being in want of funds, through a broker, sub-pledged the securities to the defendant, as collateral security for his own promissory note for $1,500, made payable to the broker, and indorsed by him to the defendant. Subsequently the amount due on the Russell note was reduced to $1,000. Without making any tender, an action of trover was brought by the representatives of

negotiable instruments limited to the first use thereof. The sub-pledgee receiving such collaterals, properly indorsed, before maturity, in good faith, for value, and without notice of equities, is a holder for value, in the usual course of business, as against all the world, equally with the first pledgee, receiving the same under like conditions. The sub-pledgee may, in the absence of notice of the rights of the original pledgor, transfer or again sub-pledge such securities to any person to the extent of his own advances; and upon a bona fide advance of a valuable consideration, made upon the faith and credit of such paper, before maturity, and without notice, the sub-pledgee may in turn, convey to a second sub-pledgee a greater interest in such negotiable securities than he himself possesses. The latter, as a holder for value, in the usual course of business, is entitled to enforce such collateral securities against all parties for the full face value thereof, holding any surplus for the benefit of the person or persons entitled.[1]

§81. Estoppel of Pledgor, where Pledgee has Title and Ownership.—The Sub-Pledgee a Holder for Value.—A sub-pledgee of negotiable instruments,

Jarvis against the sub-pledgee. The Court said: "It is enough that the defendant has received the scrip as collateral security for a debt, and that the debt has not been discharged. When that debt is paid, or a legal tender thereof made, as he received them only to secure the debt, he will probably deliver them to whomsoever they shall appear lawfully to belong." A tender was then made by the representatives of Russell, also deceased; but the sub-pledgee refused to deliver, as the representatives of Jarvis claimed the scrip, and shortly thereafter tendered the amount of his claim to the sub-pledgee. At a later hearing of the same case, 15 Mass. 389, all the four judges delivering opinions refer to the right of the sub-pledgee to recover the full amount of his advance as being unquestioned, although the sub-pledge, as between the parties to the original contract of pledge, was a breach of trust, "the effect of which," as said by Parker, C. J., "was not to increase Russell's (the pledgee) rights, although, under the circumstances, Rogers (the sub-pledgee) acquired a more extended right over the property than Russell had."

[1] Gould *v.* Farmers' Loan and Trust Co., 23 Hun, 322.

where the same are held with full title and apparent absolute ownership by the pledgee, is protected to the full extent of his advances thereon, although exceeding the amount for which such collateral securities are in fact held by the pledgee, provided such sub-pledgee has received the same in good faith, before maturity, for value, and without notice of antecedent equities, in the usual course of business; otherwise, he can take no greater rights than those of the first pledgee.[1] The claims of such sub-pledgees are supported upon the rule of equitable estoppel, that where a pledgor of negotiable instruments, by his indorsement and delivery thereof, has given the pledgee the title and apparent absolute ownership of such instruments, and has thus enabled him to deceive an innocent sub-pledgee, receiving the same before maturity, without notice, and for a valuable consideration advanced upon the credit of such title and ownership, the pledgor is estopped to set up any equities or defenses existing as between the pledgee and himself, to the injury and loss of the sub-pledgee. In such cases, where one of two innocent persons must suffer from the wrong and deceit of a third person, the one who, by his affirmative acts or neglects, has enabled the wrong and deceit to be done, should suffer the loss. Any other rule would be inconsistent with the acknowledged position of a pledgee or sub-pledgee of negotiable instruments, before maturity, in good faith, for value, and without notice, as a holder for value, in the usual course of business, with an unimpeachable title.[2]

[1] Jarvis *v.* Rogers, supra; Gould *v.* Farmers' Loan and Trust Co., supra.

[2] Bank of New York *v.* Vanderhoorst, 32 N. Y. 553; Manhattan Co. *v.* Reynolds, 2 Hill, 140; Poughkeepsie *v.* Hasbrouck, 6 N. Y. 216, 230; Richardson *v.* Rice, 9 Tenn. 290; City Bank *v.* Taylor 60 Ia. 66 (15 Rep. 396); Swift *v.* Smith, 102 U.S. 442; Railroad Co. *v.* Nat. Bank, Ib. 14; Collins *v.* Martin, 1 B. & P. 143. Fuentis *v.* Montis, L. R. 3 C. P. 268, 276; Langton *v.* Waite, L. R. 6 Eq. 165; Ex parte Sergant, L. R. 17 Eq. 279; Francc *v.* Clark, L. R. 22 Ch. D. 830.

§82. Distinction between Sub-Pledges of Negotiable Collateral Security, and others Non-Negotiable.—A distinction is properly drawn between cases of sub-pledge of negotiable collateral securities and of securities of a quasi or non-negotiable character, and pledges of personal property. In neither of the last-named cases, in the absence of any application of the rules of equitable estoppel, can the pledgee confer any greater right or interest than he possesses, and upon a tender or payment of the original debt, the pledgor is entitled to a return of the collateral securities, and may recover from the pledgee any special damages sustained by reason of the sub-pledge. The pledgor is entitled to such return, not withstanding the advance of the sub-pledgee is larger in amount than the original indebtedness to the pledgee.[1] This distinction was referred to in the argument of the case of Donald *v.* Suckling, in which Jarvis *v.* Rogers[2] was cited as a case of sub-pledge of negotiable securities, the decision itself being chiefly based upon

[1] Donald *v.* Suckling, L. R. 1 Q. B. 585. Cockburn (C. J.) said: "I am of opinion that the transfer of the pledge does not put an end to the contract, but amounts only to a breach of the contract upon which the owner may bring an action—for nominal damages if he has sustained no substantial damages; for substantial damages, if the thing pledged is damaged in the hands of a third party, or the owner is prejudiced by delay in not having the thing delivered to him on tendering the amount for which it was pledged. It seems to me that the contract continues in force, and with it the special property created by it, until the thing pledged is redeemed, or sold at the time specified. The pawnor can not treat the contract as at an end, until he has paid or tendered the amount of the debt." Mellor (J.) said (p. 610): "Although the pledgee can not confer upon any third person a better title or a greater interest than he possesses, yet if, nevertheless, he does pledge the goods to a third person for a greater interest than he possesses, such an act does not annihilate the contract of pledge between himself and the pawnor, but that the transaction is simply inoperative as against the original pawnor, who upon tender of the sum secured, immediately becomes entitled to the possession of the goods, and can recover in an action for any special damage he may have sustained by reason of the act of the pawnee in repledging the goods." Blackburn (J.) also agreed.

[2] 13 Mass. 105; s. c. Ib. 380.

the case of Johnson *v.* Stear[1] a pledge of dock warrants, non-negotiable instruments. In the case of Talty *v.* Freedman's Savings and Trust Company[2] the collateral security was a certificate issued by the District of Columbia Commissioners to the pledgor, upon a claim for certain work and materials, indorsed in blank. It was not regarded as a negotiable instrument in any sense, although the case of Jarvis *v.* Rogers was cited. The same distinction is briefly noted by Judge Story in his work on Bailments.[3]

§83. Sub-Pledges for Sums Larger than Original Advance.—An illustration of the rights of sub-pledgees of negotiable instruments is found in a recent case in Massachusetts. B., the holder of a negotiable promissory note for $1,500, secured by mortgage, borrowed $300 of C., assigning the note and mortgage as collateral security, reciting that the consideration for the assignment was $300. Shortly afterwards C., obtained a loan of $1,200 from D., indorsing the collateral note before maturity and assigning the mortgage, as collateral security for the advance. B., brought an action to redeem the note and mortgage from D. No notice was presumed to the sub-pledgee from the recital of the consideration of $300, nor was knowledge thereof sufficient to establish fraud on his part. The pledgor was allowed to redeem his securities upon paying the full amount for which the sub-pledgee held the note and mortgage as collateral security. The Court said: "The defendant became the holder of this note for a valuable consideration before its maturity, and had no actual notice of any equities which would defeat his right to recover an amount sufficient to secure the payment of the debt for which it was pledged. The smallness of the

[1] 15 C. B. (N. S.) 330.

[2] 93 U. S. 321.

[3] §325. "But if the pawnee should undertake to pledge the property (*not being negotiable securities*) for a debt beyond his own, or to make a transfer thereof to his own creditor, as if he were the absolute owner, it is clear that in such a case he would be guilty of a breach of trust, and his creditor would acquire no title beyond that held by the pawnee."

consideration certainly can not be treated as actual notice that the note was subject to some unknown equity, the nature of which it was the duty of the defendant to ascertain at his peril."[1]

Certain negotiable securities were deposited as collateral security with A to secure loans, who sub-pledged them to B to secure a loan made by B to himself, and on the same day B again sub-pledged the securities with others, to C for a loan to himself. B shortly thereafter became insolvent, and A, in order to obtain his securities from C was obliged to pay the full market value thereof. In a suit by A to compel the marshalling of securities by C, which he had received from B, the right of the pledgee to sub-pledge the securities for an advance, was recognized, and the further pledge by the sub-pledgee, having being made to C. who had no notice of any right, title or interest of the first pledgee, entitled C to hold the same as against all parties to the extent of his bona fide actual advances, as a greater interest in such collaterals could be conveyed by the sub-pledgee than he himself possessed.[2]

Where a sub-pledgee allows a collateral note, which is for a larger sum than the principal indebtedness, to become barred by the statute of limitations, and subsequently brings an action on the indorsement of the principal note by the first pledgee, it is a good defense thereto, that the sub-pledgee by his gross negligence has become liable for the amount of the collateral note, exceeding the amount due on the principal note.[3]

§84. The Discharge of the Sub-Pledgee.—Where negotiable collateral securities have been sub-pledged by the pledgee for an advance to himself, he can discharge himself from any obligation to the original pledgor, by delivering

[1] Brooks *v.* Rice, 130 Mass. 50.

[2] Gould *v.* Farmers' Loan and Trust Co., 23 Hun. 322.

[3] Farnell *v.* McGowan, 58 Miss. 261.

up the securities to his own pledgor, the first pledgee, at any time before an offer to redeem is made by the original pledgor.[1] Nor will an action accrue to the original pledgor against the first pledgee, for conversion of the negotiable collateral securities where, after having made a sub-pledge thereof for a loan to himself, the pledgee, before the maturity of the orginal evidence of indebtedness, or payment or tender thereof, repaid the loan made by the sub-pledgee, and received back the collateral securities.[2]

[1] Shelton *v.* French, 33 Conn. 489.

[2] Jarvis *v.* Rogers, 15 Mass. 389; Shelton *v.* French, supra.

CHAPTER X.

THE PLEDGEE'S DUTIES AS TO COLLATERAL SECURITIES.

§85. The primary purpose of collateral security
86. The pledgee of negotiable collateral securities under special agreement.
87. The pledgee as trustee of collateral securities.
88. The pledgee's duty to present, and give notice of non-payment.
89. Limitations as to pledgee's duty in giving notice
90. The duty of the pledgee to collect collateral notes.
91. The pledgee, with title, entitled to recover face value of collateral notes.
92. Limitations in certain cases, upon the pledgee's recovery.
93. The pledgee's receipt and collection of short collateral notes.
94. The pledgee's duty as to uncollectible collateral paper.
95. The use of over-due negotiable paper as collateral security.
96. Pledgee can not compromise nor surrender collateral securities.
97. Collateral securities can not be applied, without agreement, to other debts.
98. "Marshalling securities," as applied to collateral securities.
99. Sub-pledgees of collateral securities, subject to like rules.
100. Application of payments and interest on collateral securities.
101. The statute of limitations, as applied to collateral securities.
102. Production and return of collateral securities on payment or tender of debt.
103. The pledgee not required to keep identical bonds.

§ 85. THE PRIMARY PURPOSE OF COLLATERAL SECURITY.—The primary purpose of the use of negotiable instruments as collateral security for the payment of a principal note or obligation of the pledgor, is to place in the hands of the pledgee, by indorsement and delivery, the means of reimbursement for the money advanced upon the principal indebtedness, if default occurs in the payment thereof. The contract of pledge, under such circumstances, carries with it an implication that the collateral securities may be

made effectual to discharge the debt or obligation of the pledgor.[1] A pledgee has the right to determine for himself as to the occasion and mode of enforcing payment of the collateral securities, so long as he acts in good faith, and in the exercise of a reasonable judgment and discretion in view of the rights and interests of the pledgor.[2] And should the latter be dissatisfied with the judgment of the pledgee, in declining to take any proceedings upon such collateral securities, the pledgor may himself, upon giving proper indemnity, proceed to enforce the same, as against the parties bound.[3]

§ 86. The Pledgee of Negotiable Collateral Securities under Special Agreement.—The time and mode of performance of the duties of the pledgee of collateral securities, in enforcing the same by suit, or otherwise realizing the same, may be made the subject of agreement between the parties, in which event the rights of the parties will be governed thereby. Only in the event of accident, mistake or fraud, will evidence be admissible to show a parol agreement, made contemporaneously with the pledge and as part of the transaction, changing the terms of the written instrument.[4] And upon an agreement of the pledgee, by his contract, to return the collateral securities upon payment, or pay an equivalent in money, it is no defense, the debt being paid, that such collateral securities have been destroyed without his default.[5] A provision in a contract of pledge that suit shall not be brought upon collateral securities, is unavailing as a defense to the maker

[1] Wheeler *v.* Newbould, 16 N. Y. 39.

[2] Wells *v.* Wells, 53 Vt. 1.

[3] Bast *v.* Bank, 101 U. S. 93; Wells *v.* Wells, supra; Lamberton *v.* Windom, 12 Minn. 232, 241; Hayes *v.* Ward, 4 Johns. Ch. 123.

[4] Bast *v.* Bank, 101 U. S. 93; Roberts *v.* Thompson, 14 Ohio St. 1; Lee *v.* Baldwin, 10 Ga. 208; Lamberton *v.* Windom, 12 Minn. 232; Pickens *v.* Yarborough, 26 Ala. 417; Lawrence *v.* McCalmont, 2 How. 426; Soule *v.* Union Bank, 45 Barb. 111.

[5] Drake *v.* White, 117 Mass. 10.

or indorser liable thereon, their liability being unaffected by any such stipulation.[1]

§ 87. The Pledgee as Trustee of Collateral Securities.—The relation of the immediate parties to the contract, where negotiable instruments have been placed in the hands of a creditor by a debtor as collateral security, for the payment of a valid debt or obligation, resembles that of a trustee and cestui que trust. The responsibilities of the pledgee to the pledgor are similar to those of a trustee: First, to collect and apply the securities at their maturity to the payment of the debt, in the case of promissory notes and bills of exchange; though sale may be made where the collateral securities are long time negotiable bonds; and, secondly, to pay over the surplus, if any, to the pledgor. The pledgee is also likened to a trustee, as he may not deal with the trust property so as to destroy or impair its value.[2] In Vermont and New Hampshire, when a negotiable bill is indorsed as collateral security for an antecedent debt, the general property remains in the indorser, the indorsee holding it as a pledge, and taking the legal title in trust, to account for the proceeds to the princi-

[1] Nelson *v.* Eaton, 26 N. Y. 410; Bank of Chenango *v.* Osgood, 4 Wend. 607, 612.

[2] Wheeler *v.* Newbould, 16 N. Y. 392; Nelson *v.* Eaton 26 Ib. 410; Hawks *v.* Hincliff, 17 Barb. 492; Union Trust Co. *v.* Rigdon, 93 Ill. 458, 465; Zimpleman *v.* Veeder, 98 Ib. 613; Knights *v.* Palmer, 3 Pick. 185. "A person holding property or securities in pledge occupies the relation of trustee for the owner, and as such, in the absence of special power to do otherwise, is bound to proceed as a prudent owner would." Joliet Iron Co. *v.* Scioto etc. Co., 82 Ill. 548. Where the debt for which the collateral note has been pledged is paid pending action on the security, but before judgment, the pledgee collecting the money upon the judgment, holds the same as trustee for those who are legally or equitably entitled thereto. Houser *v.* Houser, 43 Ga. 415. The position of the pledgee is this: that if he sue a third party, he sues as trustee for the pledgor, as regards the difference in the amount taken between the sum which he has advanced and the amount of the bill." Reid *v.* Furnival, 1 Cr. & M. 538.

pal.[1] The fact that a promissory note absolutely transferred by indorsement and delivery so as to pass full title, was deposited as a pledge may be proved by parol.[2]

§ 88. The Pledgee's Duty to Present and Give Notice of Non-Payment.—The holder of negotiable instruments as collateral security, receiving the same so as to become a party thereto, is required to demand payment of the same at maturity, and in case of non-payment, to give proper notice to charge the parties liable thereon. The pledgee having the legal title to such securities, no other person can perform these duties; and if by the pledgee's failure or neglect, the indorsers or other parties thereto are discharged, he is responsible for any loss.[3] It is not material, in the case of bills or notes, to which the pledgor is not a party by indorsement, that immediate notice of non-payment should be given him, where the parties thereto have been properly charged.[4] In such cases the pledgor is not, within the custom of merchants, a party to the bill or note so as to be entitled to a strict regular notice, nor discharged from his principal obligation by the neglect of the pledgee to give him such notice, unless he has suffered loss or damage by reason of the failure of the pledgee in this respect.[5] Nor

[1] Austin *v.* Curtis, 31 Vt. 72; Jenness *v.* Bean, 10 N. H. 266; Williams *v.* Little, 11 N. H. 66.

[2] Wood *v.* Matthews, 73 Mo. 477.

[3] Railroad Co. *v.* Nat. Bank, 102 U. S. 14; Pickens *v.* Yarborough, 26 Ala. 417; Russell *v.* Hester, 10 Ib. 535; Rice *v.* Benedict, 19 Mich. 132; Jennison *v.* Parker, 7 Mich. 355; McLenore *v.* Hawkins, 46 Miss. 715; Jones *v.* Hicks, 52 Ib. 682; Barrow *v.* Rhinelander, 3 Johns. Ch. 614; Dayton *v.* Trull, 23 Wend. 345; Cutting *v.* Malor, 78 N. Y. 454; Hunter *v.* Moul, 98 Pa. St. 13; McLughan *v.* Bovard, 4 Watts, 308; Ormsby *v.* Fortune, 16 S. & R. 302; Whiting *v.* Paul, 13 R. I. 40; Foot *v.* Brown, 2 McLean C. C. 369; Allen *v.* King, 4 Ib. 128; Childs *v.* Corp, 1 Paine, 284.

[4] Gibson *v.* Tobey, 53 Barb. 191, 199; Hunter *v.* Moul, 98 Pa. St. 13.

[5] Westphal *v.* Ludlow, 2 McCrary, 505; Wildes *v.* Savage, 1 Story, 22; Douglas *v.* Reynolds, 7 Peters, 125; Oxford Bank *v.* Haynes, 8 Pick. 423, 428; Gibbs *v.* Cannon, 9 S. & R. 198; Hunter *v.* Moul, 98 Pa. St. 13. "The plaintiffs are not held to strict rules in regard to the presentment at maturity of the note taken

will the failure of the pledgee to present and collect at maturity collateral notes, entitle the pledgor to set up such default as payment of a judgment on the principal note.[1]

§ 89. Limitations as to the Pledgee's Duty in Giving Notice.—Where the collateral security is an accommodation bill of exchange, and the drawee has never been supplied with funds, and is bankrupt, the pledgee is not responsible for any loss resulting from his failure to make demand and give notice of non-payment, as the drawer has suffered no injury therefrom.[2] The holder of a bill of exchange, unable by due diligence to ascertain the residence of the drawer, is excused from giving him notice of the dishonor of the bill.[3] A negotiable promissory note of a third party was indorsed and delivered to a pledgee, upon an advance, showing upon its face a written memorandum, "This note is collateral security for the payment of the annexed draft of A on B of $8,000," that being also the amount of the note. Default occurred on both the bill of exchange and note; notice of non-payment was given to charge the parties on the latter, but no notice was given to the drawer of the bill. The maker of the note and acceptor of the bill, being insolvent, the pledgee brought an action against an

as collateral security and notice of non-payment to their debtor. The note was not received, although indorsed by the defendant, upon the condition that they would exercise such diligence. It does not represent the original debt, and to hold the defendant it is not necessary that the plaintiff should regularly proceed to have the note presented and protested. It was not a satisfaction or extinguishment of the original debt, and a failure to give notice of non-payment will not necessarily defeat a recovery." Westphal *v.* Ludlow, supra.

[1] Reeves *v.* Plough, 41 Ind. 204.

[2] Compton *v.* Blair, 46 Mich. 1. Or where the drawer has failed to provide other funds in place of those originally deposited, he is entitled to no notice. Rhett *v.* Roe, 2 How. 457; Sharp *v.* Bailey, 9 B. & C. 44; Claridge *v.* Dalton, 4 M. & S. 226.

[3] Rhett *v.* Roe, 2 How. 457; Putnam *v.* Sullivan, 4 Mass. 53; Duncan *v.* McCullogh, 4 S. & R. 480; Bateman *v.* Joseph, 2 Camp. 462.

indorser of the collateral note. No discharge of such indorser resulted from the failure of the pledgee to give notice to the drawer of the principal obligation. In such case, where the action is upon a collateral undertaking separate from the principal contract, the obligation upon the pledgee to give notice of non-payment is not strictly enforced, and no presumption of injury arises, as a matter of course, upon such failure.[1]

§ 90. The Duty of the Pledgee to Collect Collateral Notes.—The pledgee of negotiable bills of exchange or notes, acquires, where the same are transferred so as to make him a party thereto, the legal title in such negotiable collateral securities, and is entitled to receive the sum due upon the same from the parties liable thereon, and in the event of default, to proceed by action to collect the whole face value thereof, holding the proceeds to be applied in payment of the principal indebtedness.[2] The pledgee,

[1] Rhett *v.* Roe, 2 How. 457; Reynolds *v.* Douglas, 12 Pet. 497; Gibbs *v.* Cannon, 9 S. & R. 198; Warrington *v* Furbor, 8 East, 242; Philips *v.* Austin, 2 Taunt. 206; Wright *v.* Simpson, 6 Ves. 732.

[2] May *v.* Sharp, 49 Ala. 140; Houser *v.* Houser, 43 Ga. 415; Zimpleman *v.* Veeder, 98 Ill. 613; Loomis *v.* Stave, 72 Ib. 623; Vallette *v.* Mason, 1 Ind. 82; Slevin *v.* Morrow, 4 Ib. 425; Jones *v.* Hawkins, 17 Ib. 550; Reeves *v.* Plough, 41 Ib. 204; Williams *v.* Norton, 3 Kan. 295; Dix *v.* Tully, 14 La. Ann. 456; Overlock *v.* Hills, 8 Me. 383; Androscoggin R. R. Co. *v.* Auburn Bank, 48 Ib. 335; Bowman *v.* Wood, 15 Mass. 534; Batchellor *v.* Priest, 12 Pick. 399; Hancock *v.* Franklin Ins. Co., 114 Mass. 155; Jennison *v.* Parker, 7 Mich. 355; McLenore *v.* Hawkins, 46 Miss. 715; City Bank *v.* Perkins, 4 Bosw. 420; Nelson *v.* Wellington, 5 Ib. 178; Bank of Chenango *v.* Osgood, 4 Wend. 607, 612; Wheeler *v.* Newbould, 16 N. Y. 392; Wilson *v.* Little, 2 Ib. 443; Flagg *v.* Munger, 9 Ib. 492; Nelson *v.* Eaton, 26 Ib. 410; Nelson *v.* Edwards, 40 Barb. 279; Farwell *v.* Importers' Nat. Bank, 90 N. Y. 483, s. c. 47 N. Y. Supr. Ct. 409; Roberts *v.* Thompson, 10 Ohio St. 1; Hanna *v.* Holton, 78 Pa. St. 334; Beale *v.* Bank, 5 Watts, 530; Lyon *v.* Huntingdon Bank, 12 S. & R. 68; Tarbell *v.* Sturtevant, 26 Vt. 513; Hilton *v.* Waring, 7 Wis. 492; Northwestern Ins. Co. *v.* Insurance Co., 40 Ib. 446; Union Nat. Bank *v.* Roberts, 45 Ib. 373; Foot *v.* Brown, 2 McLean, 369. "Where promissory notes are pledged as security, the transaction ex vi termini imports authority to collect." Nelson *v.* Wellington, su-

by such action, does not become a trustee of the pledgor, and is not bound to use more than due diligence in the prosecution thereof.[1] Nor will a power of sale given to a pledgee of promissory notes as collateral security, limit or impair his right to receive payment thereof, or upon default, to compel satisfaction.[2] The pledgee's right of an action at law upon collateral notes, does not extend to the enforcement of a limited contract of guaranty, separate and independent, made by a third party with the pledgor, relative to the payment of the securities.[3] Under statutory enactments, giving a right of action to the real party in interest, a pledgee of negotiable paper, although holding the same unindorsed, is entitled upon default to bring an action thereon, and to recover.[4] The rule is applied to the assignment of a non-negotiable note with delivery.[5] Such action may be brought by the pledgee by agreement of the parties and at the pledgor's request, the title of the securities still remaining in him, in his own name, although he holds no title thereto, by proper indorsement and delivery.[6] Nor is indorsement necessary to enable a pledgee to sue upon negotiable collateral securities, where the same are payable to "bearer," and may pass from hand to hand.[7]

§91. The Pledgee, with Title, entitled to Recover face of Collateral Notes. — The transfer before

pra. "By an assignment of collateral security, a privity in contract is established, which invests the assignee with the ownership of the collateral for the purposes of dominion over the debt assigned. He alone is empowered to receive the money to be paid upon it, and to control it in order to protect his rights." Hanna *v.* Holton, supra.

[1] Cardin *v.* Jones, 23 Ga. 175.

[2] Third Nat. Bank *v.* Harrison, 10 Fed. Rep. 243; Nelson *v.* Wellington, 5 Bosw. 178; Nelson *v.* Eaton, 26 N. Y. 410; Nelson *v.* Edwards, 40 Barb. 279.

[3] National Bank *v.* Grand Lodge, 98 U. S. 123.

[4] White *v.* Phelps, 14 Minn. 271.

[5] Hilton *v.* Waring, 7 Wis. 492.

[6] Lobdell *v.* Merchants' Bank, 33 Mich. 408.

[7] Louisiana State Bank *v.* Gaienne, 21 La. Ann. 555; Houser *v.* Houser, 43 Ga. 415.

maturity of a negotiable promissory note, so as to make the pledgee a party, although as collateral security for a principal indebtedness less in amount than the notes held as collateral, vests an absolute title in the pledgee in such collateral, irrevocable except upon payment of the principal debt. The pledgee is entitled to recover of the parties to such collateral note the whole amount of its face, holding any surplus for the benefit of persons who are entitled to it.[1] It is immaterial to the maker of such collateral paper what the pledgee advanced upon the note, or upon what terms the pledgor and pledgee may settle. His obligation, as expressed in the collateral security, is an independent undertaking, and may be enforced by a pledgee advancing value in good faith, without notice, free from antecedent equities.[2] The pledgee of negotiable bonds is also entitled to collect their whole face value, applying the proceeds to the payment of the principal debt, and holding any surplus for those to whom it belongs.[3] The pledgee of bills of exchange, properly indorsed, upon the pledgor becoming insolvent, may prove for the full amount;[4] and bills of exchange, being offered for discount, and a bank advanced a part of the face value, taking a guaranty of a third person as additional security, such third person is entitled to sue the acceptor for the full amount of the bill, subject to the same trust as to any surplus as in other cases.[5] Where, upon the realization of such collaterals, a deficiency remains, the pledgee may bring a personal action against the pledgor, or may sue upon the principal note.[6]

[1] Tooke *v.* Newman, 75 Ill. 215; McLenore *v.* Hawkins, 46 Miss. 715; Jones *v.* Hicks, 52 Ib 582; Knights *v.* Palmer, 3 Pick. 185; Thayer *v.* Mann, 19 Pick. 535; Tarbell *v.* Sturtevant, 26 Vt. 513; Plant's Manuf. Co. *v.* Favey, 20 Wis. 200. Where the money obtained was misapplied by an agent of the pledgor. City Bank *v.* Perkins, 4 Bosw. 420.

[2] Tarbell *v.* Sturtevant, 26 Vt. 513; Witkins *v.* Jeffers, 30 Ga. 153.

[3] Jerome *v.* McCarter, 94 U. S. 739; Hancock *v.* Franklin Ins. Co., 114 Mass. 155.

[4] Ex parte Newton, L. R. 16 Ch. D. 330; In re Commersal, Ib. 137; ex parte Phillips, 1 M. & D. 232.

[5] Reid *v.* Furnival, 1 Cr. & M. 538.

[6] Faulkner *v.* Hill, 104 Mass. 188.

§92. Limitations in Certain Cases Upon the Pledgee's Recovery.—Where negotiable promissory notes, pledged as collateral security, are accommodation paper without consideration, or subject to an equitable set-off, or, in cases of misappropriation, as between the makers and payees and indorsers thereof, and the collateral securities are of greater amount than the loan represented by the principal evidence of indebtedness, the recovery of the pledgee against the makers upon an action thereon, is limited to the amount of his advances. The pledgee in such cases of fraud is a holder for value of the collateral note, as against the makers of such paper, to the extent only of his interest at the time he acquires the title, or has notice of the defenses to it.[1] A third party who has executed negotiable paper, so as to charge persons dealing with it with notice that it is to be used as collateral security may show, upon suit thereon by a pledgee, the identity, nature and amounts of the demands for which it was authorized to be pledged.[2] The recovery of a pledgee of bills of exchange where there had been a failure to indorse them so as to pass the legal title, was limited to actual advances.[3] The same rule as to recovery was applied where negotiable bonds had been pledged by a corporation as collateral security for the payment of its obligations, the pledgee, in an action against the company upon his collateral securities, was restricted to the amount of the debt they were given to secure.[4]

[1] Stoddard *v.* Kimball, 6 Cush. 469; Chicopee Bank *v.* Chapin, 8 Met. 40; Fisher *v.* Fisher, 98 Mass. 303; Stalker *v.* McDonald, 6 Hill, 93; Young *v.* Lee, 12 N. Y. 551; Huff *v.* Wagner, 63 Barb. 215; Farwell *v.* Importers' Nat. Bank, 90 N. Y. 483. The pledgee of a negotiable note, having the legal title by indorsement, was limited in his recovery upon an action thereon against the maker, to the amount of his debt, where the latter was entitled to an equitable set off against the insolvent payee. Nor was the pledgee allowed attorney's fees in prosecuting the action, although occasioned by the maker attempting a complete defense to the note. Bank *v.* Hemingway, 34 Ohio St. 381.

[2] Garton *v.* Union City Nat. Bank, 34 Mich. 229.

[3] Ex parte Phillips, 1 M. & D. 232.

[4] Jesup *v.* Bank, 14 Wis. 331.

§93. The Pledgee's receipt and collection of short collateral notes.—A pledgee, holding negotiable promissory notes or bills of exchange maturing at a day earlier than the principal obligation, is entitled to receive the money (being a party to the instrument) or, in event of default, upon demand, may proceed to enforce payment by action against the parties liable thereon. The authority of the pledgee as to the money thus received, which takes the place of the collateral securities theretofore held, extends, until the maturity of the principal note, only to the retention of the same.[1] The pledgee has no right to apply the proceeds of the notes held as collateral security in payment of the loan until it is due and payable. Both parties to the contract of pledge are entitled, the one to receive, and the other to pay, at the maturity of the principal note, and are not compellable to do so before, or by installments. Before the money, so received, can be applied by the pledgee in satisfaction of the principal debt, in the absence of agreement, default in the payment thereof must have occurred.[2] Standing in the place of the collateral security, the pledgee, holding the proceeds of short negotiable collateral notes, pledged to secure the payment of a demand note, is not entitled to apply them in payment until demand.[3] The pledgee, in accounting upon settlement with the pledgor for his collections upon short collateral notes, is required to credit such sums only as he was able legally to collect.[4] A negotiable promissory note of a third party intrusted to a broker for sale, was fraudulently pledged with other securities, for a loan, and the note maturing before the loan became due, the maker was obliged to pay its full value to

[1] Farwell *v.* Importers' etc. Nat. Bank, 90 N. Y. 483, 490; s. c. 47 N. Y. Supr. Ct. 409; Garlick *v.* James, 12 Johns. 148; Jones *v.* Hawkins, 17 Ind. 550; Wheeler *v.* Newbould, 16 N. Y. 362; Nelson *v.* Eaton, 26 Ib. 410, 417.

[2] Wilson *v.* Little, 2 N. Y. 443; Lewis *v.* Varnum, 12 Abb. Pr. 305; Garlick *v.* James, 12 Johns. 148.

[3] Lewis *v.* Varnum, 12 Abb. Pr. 305.

[4] Blouin *v.* Hart, 30 La. Ann. 714.

the pledgee. The maker gave notice to the pledgee of the misappropriation of his note, and claimed a lien on any surplus arising from the sale of other securities immediately upon notice of the fraud. He received so much of such surplus arising from the other securities as equaled the amount of his payment.[1]

§94. The Pledgee's duty as to uncollectible Collateral paper.—If a negotiable promissory note, indorsed as collateral security, proves to be uncollectible, the duty of the pledgee is to return the same to the pledgor. The pledgee is not required to bring a useless action to enforce the payment of such paper, but may at once upon default, sue upon the principal note.[2] No presumption of payment of the principal debt, however, arises from the retention of collateral securities, the makers of which are notoriously insolvent.[3] Although a pledgor may insist upon active measures to collect, if he anticipates the insolvency of parties liable on collateral securities, the right is only enforced upon equitable terms.[4] A pledge by one of several joint debtors, all insolvent, of a note of a third person, also insolvent, as collateral security, without any restriction, confers upon the pledgee an implied authority to release the maker of such collateral note upon the payment of a sum less than its face.[5]

§95. The use of over-due negotiable paper as Collateral Security.—The pledgee of a promissory note of a third person, receiving the same, after dishonor, as collateral security, is bound only by an implied promise of the

[1] Farwell *v.* Importers' etc. Bank, 90 N. Y. 483.

[2] Clark *v.* Young, 1 Cranch, 181; Wood *v.* Matthews, 73 Mo. 479; Smith *v.* Felton, 85 Ind. 223.

[3] Powell *v.* Henry, 27 Ala. 612.

[4] Lamberton *v.* Windom, 12 Minn. 232, 241; Hayes *v.* Ward, 4 Johns. Ch. 123.

[5] Exeter Bank *v.* Gordon, 8 N. H. 66, 82.

use of ordinary care and diligence in the collection thereof.[1] The parties to the contract of pledge of such paper may agree as to whether collection of them by action should be attempted, or upon further default in payment, a sale should be made thereof.[2] Generally, the pledgee holding dishonored paper, after an unsuccessful attempt to secure payment by the parties thereto, is entitled to sell the same, after reasonable notice to the pledgor, at public sale.[3] The pledgee, without consent, is not at liberty to extend the time of payment of such paper.[4] A pledge of a bill of exchange, dishonored, but which had been paid and taken up by the pledgor, was supported, although made by delivery merely, as against a mortgage covering the bills and other property.[5] The recovery of the pledgee of over-due paper is restricted, where received as collateral security for a debt of less than its face, to the amount of the debt, unless the pledgee, as a party to the paper, be liable to the pledgor or some third person for the difference. Upon proof of specific payments to the pledgor, before transfer, to an amount exceeding the difference between the debt and the face value of the paper, the pledgee can only recover the balance due, although less than the debt.[6]

Past due commercial paper, negotiated as collateral security, is subject in the hands of the pledgee to all defenses and equities which existed and attached to the paper itself in the hands of the original holder, but not to equities

[1] Craig *v.* Parkis, 40 N. Y. 181; Ward *v.* Morgan, 5 Sneed, 59; Noland *v.* Clark, 10 B. Mon. 239; Lindley *v.* Chase, 104 Mass. 253; Wakeman *v.* Goudy, 10 Bosw. 408; Rice *v.* Benedict, 19 Mich. 132. The pledgee has no right to determine for himself whether the collateral note is collectible. It is incumbent upon him to ascertain the fact by a resort to the ordinary process of the law. Craig *v.* Parkis, supra.

[2] Rice *v.* Benedict, 19 Mich. 132; Mullen *v.* Morris, 2 Pa. St. 85; Whipple *v.* Blackington, 97 Mass. 476; Union Trust Co. *v.* Rigdon, 93 Ill. 458.

[3] Potter *v.* Thompson, 10 R. I. 1, 8.

[4] Wakeman *v.* Goudy, 10 Bosw. 408.

[5] Sanders *v.* Davis, 13 B. Mon. 432.

[6] Bond *v.* Fitzpatrick, 8 Gray 536.

or defenses arising out of collateral matters.[1] A set-off against the payee is no defense against the holder of a promissory note, transferred after maturity as collateral security.[2] But the indorsee of a negotiable note receiving the same dishonored is subject to the equities arising from a misappropriation by the payee of collateral securities given for its payment, and of the proceeds of which only a part was credited upon the note, in seeking to collect the same from the maker.[3] Where such negotiable instruments are sold or pledged, after maturity, by one who is not their owner, and who in fact is not authorized to pledge the same, the pledgee acquires no title or rights thereto, and is not protected as against the claims of the true owner, who has been defrauded.[4]

§ 96. PLEDGEE CANNOT COMPROMISE NOR SURRENDER COLLATERAL SECURITIES.—The pledgee of negotiable securities as collateral security is not permitted, in the absence of special agreement, in his dealings with the securities, to accept anything less in discharge or satisfaction of them, from the parties bound, than the face value of such paper. Any trade, or compromise, or rebate made by the pledgee with the maker or other parties to such collaterals, whereby the same are surrendered for less than the face value thereof is a breach of the duty of the pledgee and is not sustained.[5] Any arrangement whereby the securities are transferred for less than is due thereon to a party already

[1] Simpson *v.* Hall, 47 Conn. 417; Robinson *v.* Lyman, 10 Ib. 30; Fairchild *v.* Brown, 11 Ib. 49.

[2] Wilkinson *v.* Jeffers, 30 Ga. 153.

[3] Creech *v.* Byron, 115 Mass. 324.

[4] Stern *v.* Germania Bank, 34 La. Ann. 1119; Henderson *v.* Case, 31 La. Ann. 215; Bird *v.* Cockrem, 28 Ib. 70; Davis *v.* Bradley, 26 Ib. 555; Civ. Code, Lou. 2452; Fowler *v.* Brantly, 14 Pet. 318; Andrews *v.* Pond, 13 Ib. 65; Foley *v.* Smith, 6 Wall. 493; Vermilye *v.* Adams, 21 Ib. 143.

[5] Wood *v.* Matthews, 73 Mo. 479; Garlick *v.* James, 12 Johns. 146; Depuy *v.* Clark, 12 Ind. 427; Hawks *v.* Hinchcliffe, 17 Barb. 492; Union Trust Company *v.* Rigdon, 93 Ill. 471; Zimpleman *v.* Veeder, 98 Ib. 613; Stevens *v.* Hulbert Bank, 31 Conn. 147; McLenore *v.* Hawkins, 46 Miss. 715.

bound for the full amount, is a compromise, notwithstanding a power of sale has been given by the contract of pledge.[1] But a compromise is sustained where it is made upon the agreement of all parties, even where made for a less sum than that authorized, if a credit be given on the principal note for the proper amount, and where this is done, the pledgee may collect the balance of the principal debt.[2] Where one of several joint insolvent debtors has pledged to the creditor the note of a third person, also insolvent, as collateral security, without any restriction, the creditor has an implied authority to release the maker upon his paying part of the sum due on the collateral note.[3] And cases may occur where a debt is not well secured and the pledgee may take less than is due and surrender the note. But this cannot be done where the debt is well secured.[4]

Where negotiable promissory notes held as collateral security, are fraudulently surrendered to the maker by the pledgee, at a sum considerably below their face value, the pledgor has his election to bring his action against the maker to recover the residue of the face of the notes so surrendered, or against the pledgee in tort for disposing of the collateral notes in a fraudulent manner. In such cases the pledgor may recover as damages the face value of such securities, subject to the equitable set-off of the principal

[1] Union Trust Co. *v.* Rigdon, 93 Ill. 471. An absolute power of sale, without notice, of the pledged collateral paper was given, upon default, and the pledgee transferred the same, which had matured in his hands, to the maker thereof for less than its face, and for an amount precisely sufficient to pay the principal debt. Such a transaction was a compromise, and not a sale, even under the extensive powers conferred. Where a collateral note was sold under a power of sale, the maker thereof but not the pledgor being notified, it was a compromise, and not such a sale as contemplated under the contract of pledge. Zimpleman *v.* Veeder, 98 Ill. 613.

[2] Thayer *v.* Putnam, 12 Met. 297.

[3] Exeter Bank *v.* Gordon, 8 N. H. 66, 82.

[4] Zimpleman *v.* Veeder, 98 Ill. 613.

debt, if unpaid.[1] The pledgee may show in defense, that the collateral securities were accommodation paper, for which no value was paid, or that there was a legal defense to the notes so surrendered.[2] Where a valid delivery had been made of the principal debt, with the collateral securities, to a third party, and the latter wrongfully surrendered the collateral notes to the maker thereof, the first pledgee is not liable in trover for such conversion.[3]

§ 97. COLLATERAL SECURITIES CANNOT BE APPLIED WITHOUT AGREEMENT TO OTHER DEBTS.—In cases where negotiable securities have been pledged for the payment of a particular debt or obligation, the pledgee is not permitted, in the absence of a special agreement, to retain the same, after payment or discharge of such debt or obligation, as collateral security for other special or general indebtedness of the debtor.[4] Where, however, the pledgor, after depositing collateral security for a specific debt, less in amount than the value of such collateral paper, agrees that the surplus, if any, arising from the sale or collection thereof shall be a pledge for other debts, such contract is enforced. In the application of the proceeds of such collaterals, the money is applied first to the debts of the oldest standing.[5] Where a pledge of negotiable securities had been made by a bank on one account, and subsequently

[1] Garlick *v.* James, 12 Johns. 146; Depuy *v.* Clark, 12 Ind. 427; Union Trust Co. *v.* Rigdon, 93 Ill. 471; Hawks *v.* Hinchcliffe, 17 Barb. 492.

[2] Union Trust Co. *v.* Rigdon, supra.

[3] Goss *v.* Emerson, 23 N. H. 38.

[4] James' App., 89 Pa. St. 54; Buckley *v.* Garrett, 60 Ib. 333; Selden *v.* National Bank, 69 Ib. 424; Wilmerding *v.* Hart, Hill & D. Supp. 305; Robinson *v.* Frost, 14 Barb. 536; Lane *v.* Bailey, 47 Ib. 395; Duncan *v.* Brennan, 83 N. Y. 487; Jarvis *v.* Rogers, 15 Mass. 397; Neponset Bank *v.* Leland, 5 Met. 259; Hancock *v.* Franklin Insurance Co., 114 Mass. 155; Hathaway *v.* Fall River Nat. Bank, 131 Ib. 14; Chester *v.* Wheelwright, 15 Conn. 562; Teutonia Nat. Bank *v.* Loeb, 27 La. Ann. 110; Latham *v.* Chartered Bank of India, L. R. 17 Eq. 205; Wyckoff *v.* Anthony, 90 N. Y. 442; Talmadge *v.* Third Nat. Bank, 91 N. Y. 531.

[5] Jones *v.* Benedict, 83 N. Y. 79, 88; Pattison *v.* Hull, 9 Cow. 747, 775 *n.* b.

another pledge of other securities was made on another account, and the pledgor, after returning the consideration for the second pledge, became bankrupt, and some of the securities given on the first occasion proved worthless, the pledgee was allowed to appropriate certain of the collaterals pledged on the second transaction in order to make himself whole on the first, as against an assignee in bankruptcy seeking to set aside the application of the securities by a summary objection to proof by the pledgee of an independent debt due to him arising out of a deposit account.[1]

§ 98. "MARSHALLING SECURITIES" AS APPLIED TO COLLATERAL SECURITIES.—The election of the pledgee, holding several collateral securities for the principal debt, as to which of the said securities shall be resorted to, in order to enforce payment of the original debt, is subject to the equitable principle known as "marshalling securities." By this rule a creditor having a lien upon two funds for payment of his debt, and a subsequent creditor a lien upon one only of such funds, the former is required to exhaust his remedy against the fund which is especially given for his security before resorting to that in which the subsequent creditor is interested. The rule, however, is never enforced in cases where it would cause an injury or damage to a creditor holding such liens upon separate funds, or would work injustice to other parties.[2] The rule was applied where a merchant had forwarded his note to a broker for sale, and the proceeds, less commissions, remitted. The broker

[1] In re McVey, 13 Fed. Rep. 443.

[2] Cheeseborough *v.* Millard, 1 Johns. Ch. 409, 413; Door *v.* Shaw, 4 Johns. Ch. 17; Wiggin *v.* Dorr, 3 Sumn. 310; Greenwood *v.* Tyler, 1 R. & M. 187; Morrison *v.* Kuntz, 15 Ill. 193; Dumont *v.* Fry, 13 Fed. Rep. 423; Hazard *v.* Fiske, 83 N. Y. 287; ex parte Kendall, 17 Ib. 520; Aldrich *v.* Cooker, 8 Ves. 388; in re International Ins. Co., L. R. 2 Ch. D. 476; Heyman *v.* Dubois, L. R. 13 Eq, 158; in re Mower's Trusts, L. R. 8 Eq 110; Merchants' Bank *v.* Maud, 18 W.R.312; Farquharson *v.* Flower, L. R. 3 Ch. D. 109; Tomkins *v.* Colthurst, L. R. 1 Ib. 626; Trumper *v.* same, L. R. 14 Eq. 295; ex parte Alston, L. R. 4 Ch. 168

fraudulently pledged the note, with other collaterals, to a bank, to secure a loan to himself, of which the merchant received nothing. The merchant, learning of the misappropriation, gave notice to the bank, and claimed to be subrogated to any surplus arising from other securities held by it, after payment of the loan. Subsequently, and before the maturity of the loan, the note fell due, and was paid without suit. Upon realizing the other securities the bank held a surplus in its hands. The merchant was entitled to be paid from such surplus, his voluntary payment not affecting his right of recovery.[1]

§ 99. Sub-Pledgees of Collateral Securities subject to like rules.—The like rule is applied to sub-pledgees of collateral securities. Where such sub-pledgee holds securities belonging to several persons which are wrongfully sub-pledged by the pledgee thereof, he is required to proceed *pari passu* in the application of the securities to the payment of the debt. A sacrifice of the securities of any one pledgor is not permitted; and in the event that the sub-pledgee shall have sold the securities of of any one pledgor, realizing sufficient to pay off all of the liabilities of the pledgee, and leaving the other securities in his hands, a court of equity will, at the suit of the pledgor whose securities have been sold, order the remaining securities to be disposed of and the proceeds so applied as to secure the payment of the debt in equitable proportions.[2] A pledged negotiable bonds to B for value, who sub-pledged them to C for value, and C again sub-pledged them to D, a trust company, together with other collaterals, for a specific loan, other loans being due from C to D, secured by collaterals. C became insolvent, and B redeemed the securities of A by paying D their full market value. Subsequently upon a sale by D of the other collateral securities

[1] Farwell *v.* Importers' Nat. Bank, 90 N. Y. 483.

[2] Gould *v.* Central Trust Co., 6 Abb. N. C. 381, which is approved in Farwell *v.* Importers' Nat. Bank, supra.

pledged for the specific loan, a surplus was left after paying the same, although all the securities held by D were not equal to the amount of the loans. D, under the equitable doctrine of marshalling of assets, was required to apply the other securities held for the specific loan to its satisfaction before resorting to the securities of A, and as upon such application a surplus remained in D's hands, the same was paid to the pledgee.[1]

§ 100. APPLICATION OF PAYMENTS AND INTEREST ON COLLATERAL SECURITIES.—Where collateral securities are received by the pledgee for a specific loan or debt, under a contract giving the pledgee the power upon default of converting such securities into available funds, the law, upon such realization, makes an application of the money in the payment at maturity of the loan or debt. Upon such application, the debt or loan is paid, so that no action thereon can be maintained against the pledgor. For any surplus remaining in the hands of the pledgee after satisfaction of the debt, the pledgor has his action as for money had and received.[2] Where the principal note is by its terms payable by instalments, some of which are over-due, the holder, may, in the absence of special directions from the pledgor, apply the proceeds of collateral securities in payment of such over-due instalments as he may desire.[3]

The pledgee of negotiable instruments, such as bonds or long-time notes, bearing interest, is entitled to collect interest accruing thereon, and to give proper receipts, accounting to the pledgor therefor upon payment of the debt at maturity.[4] Such collections upon collateral securities, in the case of promissory notes, indorsed thereon from time to time, are deemed as payments upon the

[1] Gould *v.* Farmers' L. & T. Co., 23 Hun. 322.

[2] Hunt *v.* Nevers, 15 Pick. 500, 504 (Shaw, C. J.); In re Litchfield Bank, 28 Conn. 575.

[3] Saunders *v.* McCarthy, 8 All. 42.

[4] Androscoggin R. R. Co. *v.* Auburn Bank, 48 Me. 335; Whipple *v.* Blackington, 97 Mass. 476; Hancock *v.* Franklin Ins. Co., 114 Ib. 155.

original note or other evidence of indebtedness by the principal debtor at the time such funds are received,[1] and operate as a stay to the running of the statute of limitations on the original debt.[2] The pledgee is chargeable with interest where he uses the money, so collected, for his own purposes.[3] It is not a conversion of pledged securities, where a railroad company having pledged its own bonds as collateral security, the pledgee cut therefrom, and collected the interest coupons as they became due. The collection of such dividends is properly within the powers of the pledgee.[4]

§ 101. THE STATUTE OF LIMITATIONS, AS APPLIED TO COLLATERALS.—The statute of limitations defeating simply the remedies upon a debt, does not operate in law as a discharge of the debt itself which remains, so that, where negotiable instruments have been deposited as collateral security for the payment of a loan or debt, the pledgee is entitled to retain possession of the same as against the pledgor notwithstanding the statute of limitations might be pleaded to an action on the original note.[5] Under the Louisiana code, so long as the pledgee retains possession of collateral securities, prescription or limitation does not run against a negotiable promissory note or other evidence of debt.[6] A payment made to the pledgee by a third party on a note held as collateral security, made without authority of the pledgor, and without any new promise from him, does not stop the running of the statute as against the principal evidence of indebtedness.[7] A pledgee re-delivered a note

[1] Whipple *v.* Blackington, 97 Mass. 476; Haven *v.* Hatheway, 20 Me. 345; Porter *v.* Blood, 5 Pick. 54.

[2] Whipple *v.* Blackington, supra.

[3] Morgan *v.* Mechanics' Banking Assn., 19 Barb. 584.

[4] Androscoggin R. R. Co. *v.* Auburn Bank, supra.

[5] Chouteau *v.* Allen, 70 Mo. 290, 341.

[6] Blanc *v.* Hartzog, 23 La. Ann. 199; Police Jury *v.* Duralde, 22 Ib. 107; Citizens' Bank *v.* Knapp, Ib. 117.

[7] Harper *v.* Fairley, 53 N. Y. 443.

of an insolvent person to the pledgor, upon an agreement that anything received thereon should be credited on the debt, and the pledgor collected a dividend, as agent of the pledgee, handing over the proceeds, together with the note, on the same day. The running of the statute was stopped by such payment.[1]

§ 102. PRODUCTION AND RETURN OF COLLATERALS ON PAYMENT OR TENDER OF DEBT.—Upon payment or tender of the debt the pledgor is entitled to a return of the collateral securities which he has deposited with the pledgee,[2] but a mere offer to pay, without an actual tender, is not sufficient,[3] and a tender having been made, it must be kept good where suit is brought by paying the same into court.[4] Upon a demand for payment of a promissory note made upon an indorser thereof, the note containing a statement that collaterals had been deposited with authority to the pledgee to sell, without notice, in case of non-payment, the indorser demanded of the notary a return of the collaterals upon payment, which he tendered. The notary, failing to produce the same, the indorser was discharged, as to constitute a valid demand the collaterals must be produced or had in readiness to be surrendered on payment.[5] Where promissory notes secured by mortgage were pledged as collateral security for a loan, and upon default in payment of the loan the pledgee foreclosed the mortgage, the only relief of the pledgor, after tender of the amount due, and a demand for the return of his collateral securities, is in equity, an action for trover not being sustainable.[6]

[1] Whipple *v.* Blackington, 97 Mass. 476.

[2] Bank of Rutland *v.* Woodruff, 34 Vt. 89; Hale *v.* Rider, 5 Cush. 231; Spalding *v.* Bank, 9 Pa. St. 28; Stuart *v.* Bigler, 98 Ib. 80; Lewis *v.* Mott, 36 N. Y. 402; Ocean Nat. Bank *v.* Faut, 50 Ib. 474; Whipple *v.* Blackington, 97 Mass. 476.

[3] Lewis *v.* Mott, 36 N. Y. 402; Strong *v.* Blake, 46 Barb. 222; Bateman *v.* Poole, 15 Wend. 637; Edmondson *v.* McLeod, 16 N. Y. 543.

[4] Smith *v.* Felton, 85 Ind. 223.

[5] Ocean Nat. Bank *v.* Faut, 50 N. Y. 474.

[6] Rice *v.* Dillingham, 73 Me. 59.

§ 103. THE PLEDGEE NOT REQUIRED TO KEEP IDENTICAL BONDS.—The pledgee of negotiable coupon bonds, receiving the same as collateral security for a loan, or having purchased the same upon margins for a principal, holding the bonds as security for advances and charges, is not permitted to speculate in such bonds while so held. Such bonds are like shares of stock in an incorporated company, without "ear-marks," and in the absence of a special contract by the parties that the pledgee shall retain the identical bonds, the duty of the pledgee is regarded as satisfied so long as he always retains a similar number of like bonds in his possession, so that upon payment of the debt at any time and at maturity, the collateral securities may be returned to the pledgor.[1] Where bonds so held as security have fluctuated very greatly in value, and upon tender, other like bonds, then become worthless, are offered, it is necessary for the pledgee to show he has always retained a sufficient number of like bonds to meet his obligations under the contract of pledge, *non constat*, that he sold the bonds when they were of value, and has re-purchased them since their depreciation.[2]

[1] Levy *v.* Loeb, 85 N. Y. 365; Stuart *v.* Bigler, 98 Pa. St. 80; Gilpin *v.* Howell, 5 Ib. 41.

[2] Stuart *v.* Bigler, supra.

CHAPTER XI.

THE ENFORCEMENT OF COLLATERAL SECURITIES.

§104. The pledgee's action on principal note while holding collateral securities.
105. The pledgee's action on the principal note supported.
106. Production of collateral securities upon action on the principal note.
107. And the principal note upon suit on collateral paper.
108. Collateral paper unaffected by merger of note into judgment.
109. Action upon antecedent debt not affected by receiving collateral securities, without more.
110. Nor, if transferred as collateral security for simple contract debts.
111. Election of pledgee as to enforcement of collateral securities.
112. Liabilities of parties to negotiable collaterals, when unaffected.
113. Concurrent remedies upon the principal note and collateral securities.
114. The care in collection of collaterals required of the pledgee.—His responsibility for loss.
115. The pledgee, when not liable for mere delay in collection of collateral securities.
116. The pledgee, when not liable for negligence of agent.

§ 104. THE PLEDGEE'S ACTION ON PRINCIPAL NOTE, WHILE HOLDING COLLATERAL SECURITIES.—The negotiable promissory note or bill of exchange executed and delivered by the pledgor, upon securing an advance, as his own personal obligation in respect thereto, is the principal evidence of the indebtedness as compared with the collateral notes indorsed to the pledgee to secure its payment. The promise of the maker to pay a certain sum at a certain time to a certain person therein named, or order, is not affected by the deposit of promissory notes of third parties as collateral security, and the pledgee is entitled to proceed by action upon default in payment of the principal note, at

maturity, to enforce the personal liability of the pledgor irrespective of the fact that he holds the notes of other persons as collateral security. The pledgor is entitled to a return of such collateral paper only upon the condition of first repaying the moneys advanced, or making a due tender thereof to the pledgee.[1] The only condition precedent to the right of action of the pledgee against the pledgor upon his personal obligation, is the failure of the latter to pay his note at maturity. Upon such default, the right of action immediately accrues.[2]

§ 105. The Pledgee's action on the Principal Note supported.—The obligation of the pledgor upon his personal note, when sued thereon by the pledgee, is not discharged or affected by the fact that the pledgee has failed to collect when due, the note of a third person held as collateral security, and still retains possession thereof, where there was no gross neglect or bad faith on the part of the pledgee in relation thereto. The pledgee is entitled to recover the whole face of the principal note.[3] Nor where, having sold the negotiable collateral notes deposited, the pledgee himself became the purchaser, and the relation of

[1] Sonoma Valley Bank *v.* Hill, 59 Cal. 107; Robinson *v.* Hurley, 11 Iowa, 410; Rich *v.* Boyce, 39 Md. 314; American Nat. Bank *v.* Harrison Wire Co., 11 Mo. App. 446; Winthrop Savings Bank *v.* Jackson, 67 Me. 570; Royal Bank *v.* Railroad Co., 100 Mass. 444; Beckwith *v.* Sibley, 11 Pick. 482; Townsend *v.* Newell, 14 Ib. 332; Whitwell *v.* Brigham, 19 Ib. 117; Hale *v.* Rider, 5 Cush. 231; Taylor *v.* Cheever, 6 Gray, 148; Butterworth *v.* Kennedy, 5 Bosw. 143; Langdon *v.* Buel, 9 Wend 80, 83; Case *v.* Boughton, 11 Ib. 106; Elder *v.* Rouse, 15 Ib. 218; Munger *v* Albany City Bank, 85 N. Y. 580; Farmers' Ins. Co. *v.* Wilkinson, 35 N. J. Eq. 160; Bank *v.* Woodruff, 34 Vt. 89. Where an insolvent corporation had pledged to a bank bills and notes to secure the payment of indebtedness, part of the collateral security being still held by the pledgee, an action by it, under §322 of Civ. Code of Cal., against a stockholder in such corporation to recover his ratable proportion of the indebtedness, was supported, the liability of the stockholder making him a principal debtor. Sonoma Valley Bank *v.* Hill, supra.

[2] Taylor *v.* Cheever, 6 Gray, 146.

[3] Marschuetz *v.* Wright, 50 Wis. 175.

the pledge continuing, an action is brought upon the principal note. The pledgor is not entitled to set off the full value of the securities at the time of the void sale as against his liability upon the note.[1] The pledgee may attach the property of the pledgor to respond to the execution in his action upon the principal demand.[2] A debtor procured a note of a third person, and pledged it as collateral security for his own note, the pledgee having indorsed the same, obtaining discount of the collateral note. At maturity, the note was dishonored, and the pledgee was obliged to take it up. Other notes were then substituted, one being paid, the second protested. The pledgee then sued upon the principal note. He was allowed to enforce the note without surrendering the unpaid collateral note until he had been paid his debt.[3] The loss of the collateral security by theft, without negligence, before the maturity of the principal note, is no defense as against an action on the note, the duty of the pledgee relative to the safe-keeping of such collateral security, an United States government bond, being an independent promise, and not a condition of the promise in the principal note.[4]

§ 106. Production of Collateral Securities upon action on the Principal Note.—The pledgee of negotiable collateral paper, although entitled, upon default, to enforce payment of the principal obligation, and to retain such collateral securities until payment, should be ready, in such action, in order to entitle himself to judgment, to produce the negotiable collateral securities, or account satisfactorily for their non-production, as they may have passed before maturity into the hands of bona fide holders for value, without notice,[5] being the rule enforced in actions upon

[1] Killian *v.* Hoffman, 6 Bradw. 200.

[2] Whitwell *v.* Brigham, 19 Pick. 117.

[3] Hunter *v.* Moul, 98 Pa. St. 13.

[4] Winthrop Savings Bank *v.* Jackson, 67 Me. 570.

[5] Stuart *v.* Bigler, 98 Pa. St. 80; Spalding *v.* Bank, 9 Ib. 28; Lucas *v.* Harris, 20 Ill. 167; Carr *v.* Field-

negotiable instruments.[1] Nor is it a good reason for the non-production of such negotiable collateral securities, that they have, since the time of pledge, become valueless, as *non constat*, they may have been negotiated by the pledgee while they were still of value.[2] Upon the non-production of negotiable collateral securities, and failure to account therefor, the pledgee is charged with the face value of the same, as they may have passed before maturity to an innocent indorsee, without notice of antecedent equities, the pledgee having the full title to them.[3] Upon proof that the maker of a negotiable promissory note indorsed as collateral security, was solvent for some time after its maturity, the pledgee, seeking to enforce the principal note, and failing to produce the negotiable collateral note, was charged with the face value thereof, as a payment upon such principal obligation.[4] If such negotiable collateral securities are placed in the hands of a third party selected by the pledgor, and are not under the control of the lender, no defense against an action upon the principal indebtedness arises from the loss of them.[5] An objection founded upon the non-production of negotiable collateral securities upon which judgment had been entered, comes too late when raised for the first time in an appellate court.[6]

§ 107. And of the Principal Note upon suit on Collateral Paper.—The same rule as to production of securities when seeking judgment, is applied where suit is

en, 18 Ib. 77, 81; Ocean Nat. Bank *v.* Faut, 50 N. Y. 474. See Matteson *v.* Matteson, 55 Wis. 452. A creditor, who holds a bill of exchange as collateral security, can not prove his debt in the English bankruptcy courts without producing the bill. Ex parte Jacobs, 8 R. 17 Eq. 575; ex parte Ashworth, 18 Ib. 705.

[1] Smith *v* Rockwell. 2 Hill, 482; Bateman *v.* Poole, 15 Wend. 637; Rowley *v.* Ball, 3 Cow. 303; Hausand *v.* Robinson, 7 B. & C. 90; Crow *v.* Clay, 9 Ex. 604; Anderson *v.* Heath, 4 M. & S. 308.

[2] Stuart *v.* Bigler, 98 Pa. St. 80.

[3] Spalding *v.* Bank, 9 Pa. St. 28; Lucas *v.* Harris, 20 Ill. 167; Carr *v.* Fielden, 18 Ib. 77, 81.

[4] Commercial Bank *v.* Martin, 1 La. Ann. 344; Goodall *v.* Richardson, 14 N. H. 567.

[5] Bank *v.* Peabody, 20 Pa. St. 454.

[6] Compton *v.* Blair, 46 Mich. 1.

brought upon the collateral paper. In such cases the production of the negotiable evidences of principal indebtedness is necessary where a bond and mortgage were given as collateral security for the payment of a negotiable promissory note, upon a suit to foreclose the mortgage the production and cancellation of the note was required before judgment was entered. No one would be entitled to enforce its collection after judgment, unless it had passed before maturity into the hands of a bona fide person advancing value thereon, without notice of equities. The non-production of negotiable evidences of debt, when seeking to foreclose security given for their payment, is prima facie evidence of their satisfaction.[1] Where such negotiable evidences of debt have been merged into a judgment, the note need not be produced upon subsequent proceedings upon the securities given to secure their payment. The judgment rendered upon the note is then the evidence of the debt.[2] Where judgment has been entered upon the principal debt, the collateral securities of a third person pledged for the payment are not merged in such judgment, and the pledgee is entitled to sue the pledgor upon his indorsement of such collateral notes, notwithstanding the judgment upon the principal debt.[3]

§ 108. Collateral Paper unaffected by merger of Note into judgment.—No change is created in the relations of parties to a contract of pledge by a judgment having been entered upon the principal note. The pledgee is entitled to retain and collect all collateral securities until such judgment is fully paid.[4] A distinction is drawn be-

[1] Matteson *v.* Matteson, 55 Wis. 452; Bergen *v.* Urbahn, 83 N. Y. 49; Jackson *v.* Willard, 4 Johns. 43; Langdon *v.* Buel, 9 Wend. 80; Lucas *v.* Harris, 20 Ill. 167.

[2] Conn. Mo. Ins. Co. *v.* Jones, 8 Fed. Rep. 303; Ober *v.* Gallagher, 93 U. S. 206; Wyman *v.* Cochrane, 35 Ill. 154.

[3] Steele *v.* Lord, 30 Hun. 27; Bank of Chenango *v.* Hyde, 4 Cow. 569.

[4] Smith *v.* Strout, 63 Me. 205; Comstock *v.* Smith, 23 Ib. 202; Chapman *v.* Lee, 64 Ala. 483; Whitwell *v.*

tween payment of the debt by the pledgor and a rendition of judgment upon the debt as to his rights to a return of collateral securities. Obtaining judgment is only one step to obtaining satisfaction. Demand made in an action upon a note for the surrender of the collateral securities as a condition precedent to judgment, was refused.[1] Nor where the pledgee has proved for the whole amount of his debt in insolvency proceedings against the pledgor.[2] Nor will a judgment on a note held as collateral merge or extinguish the principal debt.[3]

§ 109. Action upon antecedent debt not affected by receiving Collateral Security.—No presumption arises from the acceptance of negotiable promissory notes of the debtor or of a third person for a pre-existing debt, that the same are received in payment; nor does such acceptance, in the absence of agreement, express or implied, suspend or impair the rights of the creditor to enforce the principal indebtedness.[4] The taking of other securities of equal or inferior degree does not, in such cases, ipse facto, discharge

Brigham, 19 Pick. 117; Beckwith *v.* Sibley, 11 Ib. 483; Fisher *v.* Fisher, 98 Mass. 303; Sonoma Valley Bank *v.* Hill, 59 Cal. 107; Duncombe *v.* N. Y. etc. R. R. 84 N. Y. 193, 201; s. c. 88 N. Y. 1; Butler *v.* Miller, 1 Ib. 496, 500; Waldron *v.* Zacharie, 54 Tex. 503.

[1] Hale *v.* Rider, 5 Cush. 231.

[2] In re Litchfield Bank, 28 Conn. 575.

[3] Hawks *v.* Hinchcliffe, 17 Barb. 492.

[4] Tobey *v.* Barber, 5 Johns. 68; Jaffray *v.* Cornish, 10 N. H. 505; Peter *v.* Beverley, 10 Pet. 532; Darst *v.* Bates, 95 Ill. 512; Wilhelm *v.* Schmidt, 84 Ill. 183, 188; McIntyre *v.* Kennedy, 29 Pa. St. 448; Farmers' Ins. Co. *v.* Wilkinson, 35 N. J. Eq. 160; Bank of Rutland *v.* Woodruff, 34 Vt. 89. If the antecedent debt has passed into judgment, and the note given is dishonored, the judgment may be enforced either at law or in equity. Morris *v.* Harveys, 75 Va. 726. Suit can not be maintained in Vermont on the original indebtedness where the promissory note of the debtor, or of a third person, has been given in payment, whether the new note be paid or not. Hutchins *v.* Olcutt 4 Vt. 549; Torrey *v.* Baxter, 13 Ib. 452; Farr *v.* Stevens, 26 Ib. 299; Collamer *v.* Langdon, 29 Ib. 32; Wait *v.* Brewster, 31 Ib. 516. In Kentucky the receipt of such paper in discharge of an antecedent debt suspends the right of action on the original debt. Alexander *v.* Bank, 2 Met. 534; Greenwell *v.* Hayden, 78 Ky. 332.

a lien attaching by reason of an original security, unless an agreement of the parties that such should be its effect be shown.[1] Such agreement may be established either by proof of an express contract, or by proof of circumstances which justifies its implication.[2] If negotiable paper be indorsed as collateral security for an antecedent debt, and is dishonored while in the hands of the pledgee, the right of the latter to recover upon the original debt is not affected.[3] And an action upon the original debt is maintainable, where such negotiable collateral notes, having been discounted by the pledgee at a bank with the help of his own credit, are dishonored.[4]

In New York the decisions are that the acceptance by a creditor of a new promise payable at a future day, from his debtor in payment of an antecedent indebtedness, is no defense to a suit upon the original cause of action, even if there be an express agreement between the parties that the new security shall be a satisfaction of the old. The reason for refusing to give validity to the new promise of the debtor is that it lacks the essential requisite of a valuable consideration.[5] The rule, however, is qualified, so as not to be

[1] Schank *v.* Arrowsmith, 9 N.J. Eq. 323; Freeholders *v.* Thomas, 20 Ib. 41; Hutchinson *v.* Swartsweller, 32 Ib. 205; Wildrick *v.* Swain, 34 Ib. 167; Lord *v.* Bigelow, 124 Mass. 185; Whitwell *v.* Brigham, 19 Pick. 117; Comstock *v.* Smith, 23 Me. 202; Drake *v.* Mitchell, 3 East. 251; Belshaw *v.* Bush, 11 C. B. 191; Peacock *v.* Purcell, 14 C. B. N. S. 728; Nat. Sav. Bank *v.* Tranah, L. R. 2 C. P. 556; Cohen *v.* Hole, L. R. 3 Q. B. D. 371.

[2] Wildrick *v.* Swain, supra; Farmers' Ins. Co. *v.* Wilkinson, 35 N. J. Eq. 169.

[3] Hunter *v.* Moul, 98 Pa. St. 13.

[4] Alcock *v.* Hopkins, 6 Cush. 484; Small *v.* Franklin Co., 99 Mass. 277.

[5] Waydall *v.* Luer, 5 Hill, 448 (Judge Cowen). The case was afterwards reversed (3 Denio, 410) but on the point in question the authority of Judge Cowen's opinion was not shaken. The rule was followed in Cole *v.* Sackett, 1 Hill, 516; Hill *v.* Beebe, 13 N. Y. 556; Rice *v.* Dewey, 54 Barb. 455. Contra: Meyers *v.* Wells, 5 Hill, 463, and in Feldman *v.* Beier, 78 N. Y. 293, the court, although citing the above cases, say: "It may be assumed that, as there was no express agreement that the note should be received in full satisfaction and discharge of the past due interest, the creditor was not precluded from collecting the same." Merely taking the note of a debtor

applied in cases where a negotiable note of a third person, indorsed by the debtor, or a third person has become surety upon a new note, there being no agreement to take either the note or the additional liability of the surety, as collateral security for the original antecedent debt.[1] Where a creditor of a partnership, after the dissolution thereof, and knowing that one of the co-partners had agreed to assume and pay the debts of the firm, received the negotiable note of such partner in payment, and extended the time of payment, the other partners were discharged.[2]

§ 110. Nor, if transferred as Collateral for simple contract Debts.—In Massachusetts, where negotiable promissory notes of a third party are received, upon an agreement by the creditor to release a pre-existing simple contract debt upon payment of such collateral notes at maturity, the notes not being paid, the creditor is restored to his remedy upon the original debt.[3] If such collateral notes are discounted by the indorsee at a bank, with the help of his own credit, and are not paid, the original cause of action is revived.[4] Such collateral notes may be returned at maturity, upon their dishonor.[5] Suit may be brought upon such original simple contract debt, without returning the collateral notes, after failure to collect the same.[6] The same rule is in force in England, in cases where a negotiable instrument is given and accepted on account of a simple contract debt. The holder, upon its non-payment, may sue

in payment and giving a receipt in full, does not of itself establish an agreement to take the note absolutely in payment, and is not an extinguishment of the original debt. Putnam *v.* Lewis, 8 Johns. 389; Buswell *v.* Pioneer, 37 N. Y. 312; Muldon *v.* Whitlock, 1 Cow. 290; Feldman *v.* Beier, supra.

[1] Waydall *v.* Duer, Cole *v.* Sackett, and Rice *v.* Dewey, supra.

[2] Arnold *v.* Camp, 12 Johns 409; Millerd *v.* Thom, 56 N. Y. 402; Waydall *v.* Duer, supra.

[3] Lord *v.* Bigelow, 124 Mass. 185; Dows *v* Swett, 134 Mass. 140; The Kimball, 3 Wall. 45.

[4] Alcock *v.* Hopkins, 6 Cush. 484.

[5] Small *v.* Franklin Mining Co., 99 Mass. 277.

[6] Comstock *v.* Smith. 23 Me. 202; Whitwell *v.* Brigham, 19 Pick. 117.

upon the original debt,[1] if he has taken the proper steps to charge the parties to the negotiable collateral security.[2]

§ 111. Election of Pledgee as to enforcement of Collateral Securities.—The pledgee, holding several securities in pledge upon the same debt, is entitled to elect upon which he will proceed, subject to equitable considerations as to the rights of third persons of whose claims he has notice. Unless restricted by agreement, the pledgee may proceed upon default upon all of the collateral securities held by him, or upon one or more of them, in order to obtain satisfaction of the principal indebtedness. The pledgee holds all surplus avails of such collateral securities, after payment of his debt, for the benefit of the pledgor, or of third persons equitably entitled thereto.[3] The pledgee is required in such election to act in good faith. Should he resort specially to one collateral security held by him, equal in value to the amount of the principal debt, and by his fraudulent and wrongful sale thereof, realize much less than the value of such security, leaving a portion of the principal debt unpaid, and is proceeding to sell the remaining collateral notes, such sale is unauthorized, and the pledgee liable to account for the full value of the collateral securities.[4]

[1] Drake *v.* Mitchell, 3 East. 251; National Sav. Bank *v.* Tranah, L. R. 2 C. P. 556; Cohen *v.* Hole, L. R. 3 Q. B. D. 371.

[2] Belshaw *v.* Bush, 11 C. B. 191; Peacock *v.* Pursell, 14 C. B. N. S. 728; Valpy *v.* Oakley, 16 Q. B. 949; Miles *v.* Gorton, 2 Cr. & M. 512.

[3] Buchanan *v.* International Bank, 78 Ill. 500. "The law does not require a party to rely upon one kind of security; a claim may be secured in as many different modes as the parties may desire." He may resort to any or all to compel satisfaction of the debt. Andrews *v.* Scotton, 2 Bld. 629; Chapman *v.* Clough, 6 Vt. 123; Third Nat. Bank *v.* Harrison, 10 Fed. Rep. 243, 253; Ayres *v.* Watson, 57 Pa. St. 123; Union Bank *v.* Laird, 2 Wheat. 390; Ober *v.* Gallagher, 93 U. S. 199. Ex parte Mure, 2 Cox, 63; Darlow *v.* Cooper, 34 Beav. 281; Kellock's case, L. R. 3 Ch. 776.

[4] Mowry *v.* First Nat. Bank, 54 Wis. 38.

§ 112. Liabilities of parties to negotiable Collateral Notes when unaffected.—The liabilities of parties to negotiable instruments held by the pledgor, and indorsed by him to the pledgee as collateral security to secure the payment of a principal and independent debt, are fixed by the order in which their names appear upon the paper; and the pledgee thereof, holding by indorsement, so as to be a party thereto, for an advance, in good faith, without notice, of equities, is a holder for value, in the usual course of business, and entitled, upon default and notice, to sue the parties thereon. Nor is it material to the parties, bound upon such collateral note, that the pledgee may hold other collateral securities to secure the same debt, as their obligation to pay is an independent contract complete in itself. Where such negotiable collateral securities, executed by different makers, were indorsed as security for a principal note, although the pledgee, a bank, had a sufficiently large deposit to satisfy the principal note, and the renewals thereof, and the personal liability of the pledgor upon his own note, and a power of sale of the collaterals under the contract of pledge, yet its failure to resort to either was no defense to the liability of the parties bound upon the negotiable collateral securities in an action thereon by the pledgee.[1] Where a negotiable promissory note of a third party, properly indorsed, is received before maturity from the payee and indorser as collateral security for a valuable consideration, without notice, in good faith, the pledgee may recover thereon against the maker, although the latter has paid the note to the pledgor and payee, subsequently to and without notice of the indorsement.[2] The like rule is en-

[1] Third Nat. Bank *v.* Harrison, 10 Fed. Rep. 243.

[2] City Bank *v.* Taylor, 60 Ia. 66 (15 C. L. N. 131); Fennell *v.* McGowan, 58 Miss. 261; Vallette *v.* Mason, 1 Smith (Ind.) 89; Williams *v.* Smith, 2 Hill, 301; Mayo *v.* Moore, 28 Ill. 428; Steere *v.* Benson, 2 Bradw. 560; Dix *v.* Tully, 14 La. Ann. 460. The maker of negotiable paper is not discharged if before its maturity, and after its transfer, even as collateral security, he makes payment to any other than the real holder.

forced in cases where the maker, being chargeable with notice of the indorsement of his note as collateral security, pays the same to the payee and pledgor.[1] Such payment may be made by the consent of or authority of the pledgee, or may be subsequently ratified by him.[2] Where the pledgee of negotiable collateral notes is not liable for any surplus arising from the collection of them to the pledgor or third parties, the enforcement of such collateral securities against the parties thereto is restricted to the amount of the advances made.[3]

§ 113. Concurrent remedies upon the Principal Note and Collateral Securities.—The pledgee holding negotiable collateral securities for the payment of the pledgee's principal obligation, is entitled to proceed with the enforcement of both the principal and collateral securities, at the same time, and to judgment and execution, although entitled to but one satisfaction.[4] A suit upon the principal indebtedness may be commenced, although a suit is in progress upon the negotiable promissory note of a third party received as collateral security, and the pledgee has attached property of persons liable thereon to answer the judgment.[5] The entry of a judgment upon the principal indebtedness is not a bar to proceedings against the pledgor and other persons, makers and indorsers of collateral notes.[6] Negotiable bonds of a corporation having been sold to a bona fide purchaser for value, and other bonds pledged as collateral securities for those sold, the pledgee, in an ac-

Richardson *v.* Rice, 9 Tenn. 290, citing Gosling *v.* Griffin to same point, in note.

[1] Fennell *v.* McGowan, supra.

[2] City Bank *v.* Taylor, supra.

[3] Vallette *v.* Mason, and Williams *v.* Smith, supra.

[4] Com. Exch. Ins. Assn. *v.* Babcock, 57 Barb. 233; Butler *v.* Miller, 1 N. Y. 496; Sickles *v.* Richardson, 23 Hun, 559; Royal Bank *v.* Grand Junction Ry. Co., 100 Mass. 444; Chapman *v.* Lee, 64 Ala. 483. He may recover the costs paid by him in each suit. Plants' etc. Co. *v.* Fahey, 20 Wis. 200; Hilton *v.* Waring, 7 Ib. 492.

[5] Chapman *v.* Clough, 6 Vt. 123.

[6] Steele *v.* Lord, 30 Hun, 27.

tion upon both classes of bonds, was given a judgment for the face value of all he held, whether as vendee or pledgee. Until payment of the actual indebtedness to the pledgee, the pledgors had no equity to set up that some of the bonds were held as collateral security.[1]

§ 114. THE CARE IN COLLECTION OF COLLATERALS REQUIRED OF THE PLEDGEE—HIS RESPONSIBILITY FOR LOSS.—Where negotiable instruments made by a third party are used as collateral security for the promissory note or bill of exchange of the pledgor, so that the pledgee of them becomes a party thereto, and such collateral paper matures before the principal debt, the duty and obligation of the pledgee in the collection thereof, is performed by the exercise of reasonable and ordinary care and diligence. More than this is not required of the pledgee.[2] Although in such cases, where he has become a party to the collateral security, it is not enough for him to keep the same in safety, as no one but the pledgee can make demand of payment and give notice of dishonor, or upon default, bring an action to enforce payment by legal process.[3] Generally, the most important consideration as to the pledgee's duty relative to collateral securities is, that perfect good faith should be observed by him in his dealings therewith. If he acts in good faith, the pledgor can not complain. Only in cases of

[1] Royal Bank *v.* Grand Junction Ry. Co., 100 Mass. 444.

[2] Reeves *v.* Plough, 41 Ind. 204; Kiser *v.* Ruddick, 8 Blackf. 382; McLenore *v.* Hawkins, 46 Miss. 715; Jones *v.* Hicks, 52 Ib. 682; Noland *v.* Clark, 10 B. Mour. 239; Childs *v.* Corp, 1 Paine C. C. 284; Lawrence *v.* McCalmont, 2 How. 426. A negotiable note of a third party was pledged before due as collateral security, the debtor waiving demand and notice of non-payment. The pledgee is not required to demand and insist upon its payment before maturity, even if it will be paid, and the maker afterwards becomes insolvent. Such demand is not within the rule of ordinary diligence. Roberts *v.* Thompson, 14 Ohio St. 1.

[3] Roberts *v.* Thompson, supra. But where the collateral is simply a receipt for a note in which the pledgor had a part interest only, the pledgee is not bound to pursue its collection, and that if uncollectible the loss fell upon the pledgor. Smouse *v.* Bail, 1 Grant's Cas. 397.

fraud or gross negligence on the part of the pledgee will he be held to stricter account.[1]

If upon a pledge of negotiable collateral securities, so as to convey the title thereto, the pledgee, because of his gross negligence, or by his tortious transfer of them or dealings therewith, fails to collect the same of the parties bound thereon, when it might have been done, and the pledgor is injured and the amount of the collateral paper lost, the pledgee is chargeable with the face of such collateral securities as in payment and discharge of the principal debt.[2] Where the opportunity of collecting collateral bills or notes is lost by the insolvency of the parties thereto, by reason of the supine negligence of the pledgee, when with ordinary care the same might have been enforced, the latter is liable to account for the full loss and damage of the pledgor.[3] Such responsibility of the pledgee is limited to the actual loss.[4] The liability of the pledgor as indorser upon such negotiable collateral notes of third parties is, in such cases of gross negligence, discharged.[5]

§ 115. THE PLEDGEE, WHEN NOT LIABLE FOR MERE DELAY IN COLLECTION OF COLLATERAL SECURITIES.—The

[1] Black River Bank *v.* Page, 44 N. Y. 453.

[2] Powell *v.* Henry, 27 Ala. 612; Cooke *v.* Chaney, 14 Ib. 65; Wood *v.* Mathews, 73 Mo. 481; Lyon *v.* Huntington Bank, 12 S. & R. 69; Spalding *v.* Barr, 9 Pa. St. 28; Wakeman *v.* Goudy, 10 Bosw. 208; Roberts *v.* Thompson, 10 Ohio St. 1; Whittaker *v.* Charleston Gas Co., 16 W. Va. 717; Noland *v.* Clark, 10 B. Mon. 239; Westphal *v.* Ludlow, 2 McCrary, 505; Stuart *v.* Bigler, 98 Pa. St. 80.

[3] Hannah *v.* Holton, 78 Pa. St. 334.

[4] Grove *v.* Roberts, 6 La. Ann. 210; Barrow *v.* Rhinelander, 3 Johns. Ch. 614; Howard *v.* Gardner, 10 N. Y. 261; Baker *v.* Briggs, 8 Pick. 129. Where promissory notes secured by mortgage were held as collateral security and an action was brought for damages on account of neglect to foreclose, the measure of damages recovered was only the actual loss caused by the pledgee's neglect, as the land might still be ample security. Steele *v.* Brown, 75 Ill. 452. Lamberton *v.* Windom, 12 Minn. 232; Wakeman *v.* Goudy, 10 Bosw. 208; Slevin *v.* Morrow, 4 Ind. 425; Lyon *v.* Huntington Bank, 12 S. & R. 61.

[5] Whitten *v.* Wright, 34 Mich. 92.

pledgee of negotiable collateral securities, however, is not held to strict responsibility in proceeding at once, upon default, in the enforcement thereof. Mere delay in so doing is not sufficient to create any liability upon his part to the pledgor.[1] Where there is no suspicion that the maker is embarrassed, and no request on the part of the pledgor that collection should be promptly made, the pledgee is not answerable for a subsequent actual loss.[2] And where the pledgee has information upon which he is certain that a suit upon the collateral note would be fruitless, he is not required to sue the same.[3] The pledgee of negotiable collateral paper in order to be charged, upon failure to collect, with the face value thereof, as a payment pro tanto of the principal debt, must have been guilty of such bad faith or gross negligence that it would be unjust and inequitable to the pledgor were he not so charged.[4] In case of delay on the part of the pledgee to enforce the payment of collateral securities and possible depreciation in the value of them, after the maturity of the principal note, the pledgor, upon the equitable condition of paying or tendering the amount of his debt, becomes entitled to a return of the collateral paper while it remains of value.[5] Although he will have no right to call for a return of such collateral securities upon a payment or tender of but an aliquot or other portion of the debt;[6] the pledgee having a right to retain all the collateral securities until actual satisfaction of his whole demand or tender of the sum due.[7]

§ 116. THE PLEDGEE, WHEN NOT LIABLE FOR NEGLIGENCE OF AGENT.—The pledgee of negotiable collateral securities who has employed an agent or attorney in con-

[1] Steger *v.* Bush, S. & M. Ch. 172.

[2] Goodale *v.* Richardson, 14 N. H. 567.

[3] Smith *v* Felton, 85 Ind. 223.

[4] Wells *v.* Wells, 53 Vt. 1.

[5] Androscoggin Bank *v.* Auburn Bank, 48 Me. 335; O'Neill *v.* Whigham, 87 Pa. St. 394; In re Kettera's Est. 17 Ib. 424.

[6] In re Kettera's Est. supra.

[7] Hunter *v.* Moul, 98 Pa. St. 13; Benoir *v.* Peguin, 40 Vt. 199; Jones *v.* Merchant's Bank, 4 Robt. 221; 6 Ib. 162.

nection with the collection or realization thereof, is not liable, where he has exercised reasonable care and judgment in his selection, by reason of the misconduct or gross negligence of the person or persons employed.[1] If a pledgee of negotiable paper deposits the same in a bank or agency, for the purpose of having collections made, and such bank or agency fails or neglects to take the proper steps to charge the parties liable thereon, an action against the bank or agent may be brought in favor of anyone beneficially interested in such collateral securities. The pledgee himself is entitled to an action, the amount recovered being applied, at the maturity of the principal note, as a payment upon the same. The pledgor, upon payment of the debt, being entitled to an immediate return of the collateral securities, a right of action against the bank or agency at once accrues in his favor, as the real party in interest.[2]

[1] Commercial Bank *v.* Martin, 1 Lou. Ann. 344; Exeter Bank *v.* Gordon, 8 N. H. 66; Goodale *v.* Richardson, 14 Ib. 567.

[2] McKinster *v.* Bank of Utica, 9 Wend. 46; 11 Ib. 473; Whitney *v.* M. U. Exp. Co., 104 Mass. 153.

CHAPTER XII.

PLEDGEE'S SALE OF COLLATERAL SECURITIES.

§117. The pledgee of bills and notes has no right of sale.
118. The right of sale under contract.
119. The pledgee's relief in equity to obtain sale of collateral paper.
120. The pledgee's right to sell negotiable bonds, on default.
121. The requirements of a valid sale.
122. Notice of sale of collateral paper when provided for by contract.
123. Notice of sale by pledgee, when sufficient.
124. Right of pledgee of negotiable bonds, upon default, to enforce mortgage securities.
125. The title of bona fide purchasers for value, at sale of collateral securities.
126. The pledgee as purchaser of negotiable collateral paper.

§ 117. THE PLEDGEE OF BILLS AND NOTES HAS NO RIGHT OF SALE.—The pledgee of negotiable instruments such as bills of exchange and promissory notes, so as to become a party thereto, as collateral security for the payment of a principal note or obligation, is not entitled, upon demand of payment and default of the principal debt, and notice to the pledgor, to offer such negotiable collateral securities, at either public or private sale, in the absence of authority by special contract so to do.[1] Negotiable col-

[1] Fletcher *v.* Dickinson, 7 Allen, 23; Nelson *v.* Edwards, 40 Barb. 279; Same *v.* Wellington, 5 Bosw. 178; Brookman *v.* Metcalf, 5 Ib. 429; Brown *v.* Ward, 3 Duer, 660; Lamberton *v.* Windom, 12 Minn. 232; Zimpleman *v.* Veeder, 98 Ill. 613; Morris Canal Co. *v.* Lewis, 12 N. J. Eq. 321; In re Litchfield Bank, 28 Conn. 275; Whittaker *v.* Charleston Gas Co., 16 W. Va. 717. In Joliet Iron Co. *v.* Scioto etc. Co., 82 Ill. 548, the Court (Dickey, J.) says: "The pledge of commercial paper as collateral security for the payment of a debt does not, in the absence of a special power for that purpose, authorize the party to

lateral securities, such as bills and notes, are held by the pledgee under a quasi trust in favor of the pledgor, and are of such a character that a public or private sale is generally made at a sacrifice. The solvency or circumstances of parties to the collateral paper may not be well known and few persons will purchase, and those for speculation, and at low prices. The pledgor is not required to submit his negotiable collateral securities to an ordeal to which commercial paper is unusually subjected, and which must be destructive of its value except in rare cases.[1] The rule disapproving of sales of negotiable collateral securities either at public or private sale, without express contract authorizing such sale, applies where such collateral bills or notes mature later than the original debt or obligation,[2] but does not apply to long time paper or negotiable bonds.[3]

§ 118. THE RIGHT OF SALE UNDER CONTRACT.—A power of sale of such negotiable instruments held as collateral security may be given by the contract of pledge. Such a power is not against public policy, nor is it open to any objections as to its validity.[4] Such a power given by contract, however, so far as it enables the pledgee to extin-

whom such paper is so pledged, to sell the securities so pledged upon default of payment, either at public or private sale. He is bound to hold and collect the same as it becomes due, and apply the net proceeds to the payment of the debt so secured. From the very nature of the case, property can only be applied as security through the process of sale; not so, with bonds, mortgages, or promissory notes." Union Trust Co. *v.* Rigdon, 93 Ill. 458; Zimpleman *v.* Veeder, 98 Ib. 613; Walker *v.* Carleton, 97 Ib. 582.

[1] Wheeler *v.* Newbould, 5 Duer, 29; affirmed 16 N. Y. 392.

[2] Nelson *v.* Wellington, 5 Bosw. 187. "It will rather be presumed that it was the intention of the parties to the contract that the creditor should, if he resorted to the pledge in place of the personal liability of the debtor, accept the money upon the hypothecated securities as it became due and payable, and apply it to the satisfaction of the debt." Wheeler *v.* Newbould, 16 N. Y. 392.

[3] Fraker *v.* Reeve, 36 Wis. 85.

[4] Union Trust Co. *v.* Rigdon, 93 Ill. 458. The power to "negotiate" collateral notes, upon default, includes the right of sale. Fraker *v* Reeve, 36 Wis. 85.

guish the right of the pledgor to redeem, will as other contracts affecting equities of redemption, be construed favorably for the interests of the pledgor, so far as is consistent with the rights of the pledgee. The power of sale must be exercised with a view to the interest of the pledgor as well as of the pledgee, and a sale must not be forced for barely enough money to secure the payment of the debt; and demand of payment of the debt should generally precede it.[1] The terms of the contract govern the rights of the parties as to the time, place, and notice of sale, and must be strictly pursued.[2] Where these are not prescribed, the sale should be made openly, at a public place, and after proper notice to the pledgor.[3] It is no part of the duty of a pledgee of negotiable securities having a power of sale of securities to constantly watch the market, and take advantage of the most favorable opportunities for selling.[4] Such power of sale, upon default in payment, is not construed as excluding the right of the pledgee to sue upon such collateral notes. It is rather an additional power given him for the realiza-

[1] Sparhawk *v.* Drexel, 42 Bank R. 450; Union Trust Co. *v.* Rigdon, supra; Zimpleman *v* Veeder 98 Ib. 613; Wilson *v.* Little, 2 N. Y. 443.

[2] Union Trust Co. *v.* Rigdon, supra The power of sale in this case, which formed a part of the body of the principal note, was: "I hereby give the said A, its assign or assigns, authority to sell the said collateral notes, or any part thereof, on the maturity of this note, or at any time thereafter or before, in the event of such securities depreciating in value, at public or private sale, without advertizing the same, or demanding payment, or giving notice."

[3] Fraker *v.* Reeve and Wheeler *v.* Newbould, supra. A sale, after notice to pay or give security on the same day, is unreasonable. Stevens *v.* Hurlburt Bank, 31 Conn. 149. A form of notice for public sale: "Sale of Collateral Securities.—Notice is hereby given that the undersigned will, on the * * day of * * * at * * o'clock, * M., of said day, sell, at public vendue, to the highest bidder at [a public place or Exchange], all the following collateral securities, to wit [describing the same]. Terms of sale, cash. * * * *" This notice may be used for sales under contract (*see* § 3, *n.* 1), Special notice should be given to the pledgor, and in case of subpledge, both to the original pledgor (if known) and to the pledgee. Burnap *v.* Nat. Bank, 96 N. Y. 125, 129.

[4] Whitin *v.* Paul, 13 R. I. 40.

tion of his collateral securities.[1] The pledge of a note to one creditor as collateral security with a power of sale, does not affect the right of other creditors to levy upon the pledgee's reversionary interest therein, and to sell the same, subject to the rights of the pledgee.[2] It is questionable whether a valid sale can be made of a collateral note to the maker, at private sale, at any rate for less than its face value. Such a sale, without the consent of the pledgor previously obtained, would be "very suspicious."[3]

§ 119. The Pledgee's relief in equity to obtain sale of Collateral Paper. — Applications are rarely made to courts of equity for assistance in obtaining the realization by sale of negotiable collateral paper, such as bills of exchange and promissory notes. No ground exists, except in exceptional cases, for the aid of a court of equity, as the pledgee, receiving such collateral securities, indorsed where required so as to become a party thereto, and possessing the full legal title, has a complete remedy by an action at law against the parties bound thereon. Equitable relief was given in a case, where the maker of the collateral note resided in New York, the pledgor and pledgee in San Francisco. The maker had no property or estate in California subject to legal process, and upon presentment of the note to him for payment at maturity, it was protested. Upon a bill filed by the pledgee, a court of equity decreed that the note should be sold at a judicial sale, and that in the event of any deficiency occurring, a supplementary decree therefor should be entered as against the pledgor.[4] A pledgee

[1] Third Nat. Bank *v.* Harrison, 10 Fed. Rep. 243; Nelson *v.* Eaton, 26 N. Y. 410; Nelson *v.* Wellington, 5 Bosw. 178; Nelson *v.* Edwards, 40 Barb. 279.

[2] Pickens *v.* Webster, 31 La. Ann. 879.

[3] McLenore *v.* Hawkins, 46 Miss. 715.

[4] Donohoe *v.* Gamble, 38 Cal. 354. The court say: "The same reasons which would require the pledgee to pursue the maker with legal process in the State of New York would equally demand that he should follow him to Europe, South America, or any other foreign country, where he might be known to be

holding a negotiable bond issued by a railroad company in the United States, was given an order of sale by an English court of chancery, and allowed to purchase the same himself, he not conducting the sale.[1] And a bill in equity was sustained for a foreclosure and sale of collateral securities with a short time for redemption, where the pledgee held the full legal title to the same.[2] But upon a pledge of city certificates, indorsed in blank so as to pass the title thereto, as collateral security for the payment of the pledgor's note, and both parties resided in the city issuing the certificate, the pledgee having a complete remedy at law, the aid of equity to decree a judicial sale of the collateral security was refused.[3]

§ 120. The Pledgee's right to sell negotiable Bonds, on default. — The pledgee of long-time bonds issued by the government, municipal or other corporations, payable to bearer or holder, and negotiable by delivery, holding the same as collateral security for the payment of promissory notes or bills of exchange, maturing at early dates, has the right, even in the absence of contract, to sell such collateral securities upon default in payment of the original debt, under proper conditions as to notice of the time, place and manner of sale.[4] The presumption is that a pledgee is entitled to sell such long-time bonds, and coupons thereto attached, as stocks, public securities, goods, and

domiciled. This would impose a hardship on the pledgee which evidently was not within the contemplation of the parties. We think he may go into a court of equity for a foreclosure and sale of the note for whatever it will bring in the market at a judicial sale."

[1] Carter *v.* Wake, L. R. 4 Ch. D. 605.

[2] France *v.* Clark, L. R. 22 Ch. D. 830; Smith *v.* Coale, 12 Phila. 177.

[3] Whitaker *v.* Charleston Gas Co., 16 W. Va. 717.

[4] Jerome *v.* McCarter, 94 U. S. 734; Fletcher *v.* Dickinson, 7 Allen, 23; Washburn *v.* Pond, 2 Ib. 474; Hancock *v.* Franklin Ins. Co., 114 Mass. 155; Brown *v.* Ward, 3 Duer, 660; Morris Canal & B. Co. *v.* Lewis, 12 N. J. Eq. 321; Duffield *v.* Miller, 92 Pa. St. 286; Alexander R. R. Co. *v.* Burke, 22 Gratt. 254; Newport Bridge Co. *v.* Douglass, 12 Bush, 673.

chattels are sold, upon demand and default in payment of the principal debt, and after due notice of sale. Such collateral securities differ essentially from the ordinary negotiable notes and bills of exchange, or notes and bonds, secured by mortgage.[1] The right to sell such long-time bonds is an incident of the pledge thereof, and part of the security, and passes with the collateral securities into the hands of any bona fide holder advancing money thereon, in the due course of business.[2] The rule is otherwise where bonds issued by a railroad company are payable upon condition, so that no bidder at a public sale can, by mere inspection of the paper, form any just judgment as to the value thereof. In such a case, a sale by the pledgee is not approved.[3]

If the pledgee of negotiable bonds and other securities having, upon default in payment of the principal debt, and upon due notice, a right of sale of such collateral securities, fails to exercise such right, but continues to retain the securities in his possession, his title thereto continues to be that of a pledgee, and does not ripen into an absolute ownership.[4] The right of a pledgee of such negotiable bonds to sell is not defeated by the subsequent insolvency of the pledgor.[5] A pledgee, holding such collateral securities in value largely in excess of the principal debt, will be restrained from selling the whole.[6]

The holder of certain railroad bonds as collateral security sought by bill in chancery to foreclose the equity of redemption of the pledgor, alleging that if such bonds were sold, enough would not be realized to satisfy the debt, but

[1] Morris Canal and Banking Co *v.* Lewis, supra.

[2] Alexander R. R. Co. *v.* Burke, supra.

[3] Joliet Iron and Steel Co. *v.* Scioto Fire Brick Co., 82 Ill. 548.

[4] Hancock *v.* Franklin Ins. Co., 114 Mass. 155; Whipple *v.* Blackington, 97 Mass. 476; Fletcher *v.* Dickinson, 7 All. 23; Washburn *v.* Pond, 2 Ib. 474; Brown *v.* Tyler, 8 Gray, 135; Hunt *v.* Nevers, 15 Pick. 500; in re Litchfield Bank, 20 Conn. 575; White Mountain R. R. Co. *v.* Bay State Iron Co., 50 N. H. 57.

[5] Jerome *v.* McCarter, 94 U. S. 734.

[6] Fitzgerald *v.* Blocker, 32 Ark. 742.

that by holding the bonds until they were redeemed he would obtain payment of his debt. The court refused to decree a foreclosure, but ordered a sale of the bonds and allowed the pledgee himself to become the purchaser, he not conducting the sale.[1] This decision was distinguished in a late case, as relating to the powers of a simple pledgee only, and where the collateral securities were transferred so as to pass the legal title thereto, the holder was given an order for foreclosure, with a short time for redemption.[2]

§ 121. THE REQUIREMENTS OF A VALID SALE.—In the absence of special contract, the sale of negotiable bonds held as collateral security should be made at auction, at a public place, after demand of payment of the principal obligation, and default, and reasonable notice of the time and place of sale.[3] A sale of bonds, held as collateral security for a loan, payable on demand, made without demand or notice, is irregular, to be affirmed or not at the election of the pledgor.[4] Where such bonds had been sub-pledged, a notice of the proposed sale to the pledgee thereof, upon default, is not sufficient, as it is the duty of the pledgee to give notice also to the pledgor. Nor will the error be cured by a notice of thirty days in which to redeem.[5] A sale of bonds, held as security for the payment of advances, without authority and without notice, is a conversion, and

[1] Carter *v.* Wake, L. R. 4 Ch. D. 405.

[2] France *v.* Clark, L. R. 22 Ch. D. 830.

[3] Washburn *v.* Pond, 2 Allen, 474; Fletcher *v.* Dickinson, 7 Ib. 23; Stearns *v.* Marsh, 4 Denio, 227. In the City of New York it should be made at the Merchants' Exchange. Brown *v.* Ward, 3 Duer, 660; Cortelyon *v.* Lansing, 2 Caines' Cas. 203. A pledgee, being unable to give notice, or make demand upon the pledgor, sold the bonds pledged at private sale. The pledgor was allowed to elect either to confirm the sale, and claim the benefit of the surplus, or repudiate the sale, and hold the defendant responsible for the bonds. Strong *v.* Mechanics' Nat. Bank, 45 N. Y. 718.

[4] Stokes *v.* Frazier, 72 Ill. 428; Middlesex Bank *v.* Minot, 4 Met. 325. The rule may be waived by express agreement. Chouteau *v.* Allen, 70 Mo. 290.

[5] Fletcher *v.* Dickenson, 7 All. 25.

renders the pledgee liable for any subsequent enhancement in value.[1]

§ 122. Notice of sale of Collateral Paper when provided by Contract.—The parties to a contract of pledge of negotiable bonds and coupons, payable to bearer or holder, may stipulate that the pledgee shall have the right to sell such collateral securities, upon default of payment of the principal debt, at public or private sale, without notice to the pledgor. Such bonds generally have a recognized value in the market, and the good or bad faith of the pledgee in the realization of such collateral securities is a matter of easy proof.[2] A bona fide sale of such collateral paper, made after default, under a power of sale, vesting the title in a purchaser for value, in good faith, is not affected by a tender of the debt and charges made subsequently thereto.[3] The usual requirements of demand and notice do not apply where by the contract of pledge, a power of sale is given upon default in payment of the principal debt at a definite time.[4] And notice is considered waived where compliance with the terms of the contract of pledge requiring notice, are rendered absolutely impossible by circumstances over which the pledgee has no control.[5]

§ 123. Notices of sale by Pledgee when sufficient.—Whether the notice by the pledgee of sale of negotiable collateral securities is sufficient to constitute

[1] Reed *v.* Lambert, 10 Abb. Pr. N. S. 428.

[2] Loomis *v.* Stave, 75 Ill. 623 Chouteau *v.* Allen, 70 Mo. 290.

[3] Loomis *v.* Stave, supra.

[4] Chouteau *v.* Allen, supra, where the pledge of the bonds as collateral was made in the body of the note, the power of sale to arise "on the non-performance of this promise."

[5] City Bank *v.* Babcock, Holmes, 180. The bank had pledged certain bonds as security, with power of sale after notice. It afterwards failed and closed up, and thereafter transacted no business, nor had any officers. As performance of the condition had been rendered impossible by the act of the party for whose benefit it was made, the bonds were allowed to be sold without notice. See Strong *v.* Mechanics' Nat. Bank, 45 N. Y. 718.

such sale a valid transaction, is a question of fact depending upon the particular circumstances of each case. The pledgor has no cause for complaint where notices of the sale of municipal bonds held in pledge were published in a newspaper in a city where the bonds were issued and at the place of sale thirty days prior thereto, and that such bonds sold at the place of sale for more than in the city where issued, and the sale itself was bona fide.[1] Actual notice to the pledgor, a reasonable time before the sale, is sufficient, and will excuse want of formal notice.[2] But notice after the sale is not sufficient, for although the pledgor, having notice, might not have been able to raise funds to pay his debt and redeem his collateral securities, he has a right to be present at the sale to see that it is conducted in a proper manner, and to advance his interests by securing greater competition.[3] Where negotiable railroad bonds were pledged as collateral security for the payment of certain notes, less in amount, with authority to sub-pledge the securities to a bank for other notes indorsed by the pledgor; and, upon default in payment of the notes held by the sub-pledgee, the bonds were sold in New York, at public auction, after advertisement, for much less than their value, with the knowledge and assent of the pledgee, but of which sale the pledgor received no notice; the loss resulting from such sale was applied in payment of the notes held by the pledgee, who had failed to give the pledgor notice of the intended sale, as was his plain duty under the facts of the case.[4]

§ 124. RIGHT OF PLEDGEE OF NEGOTIABLE BONDS, UPON DEFAULT, TO ENFORCE MORTGAGE SECURITY.—Pledgees of negotiable coupon bonds of railroad and other corporations, secured by mortgage or trust deed, are entitled

[1] Washburn *v.* Pond, 2 Allen, 474.

[2] Stokes *v.* Frazier, 72 Ill. 428.

[3] Alexandria R. R. Co. *v.* Burke, 22 Gratt. 254.

[4] Washburn *v.* Pond, supra.

to require foreclosure and sale of the property covered by such mortgage or trust deed, upon default.[1] Upon such foreclosure proceedings, the bona fide holder of bonds as collateral security for a valuable consideration, is not limited to proof of the amount of his actual advances, but is entitled to prove the full face value of the bonds held by him as collateral security, and to share in the distribution accordingly, not receiving however more than the amount of the actual indebtedness secured.[2] This rule is applied in cases where it is evident that the mortgaged property is insufficient to pay the debts with which it is encumbered. If allowed to prove only for the sums for which the bonds are held as collateral security, they would probably form an insufficient security; but if the sale should realize more than sufficient to pay all the debts, the distribution of the proceeds remain under the direction of the court. Should the pledgees receive an excess over the amount of the debt for which the bonds are pledged, such surplus will be held in trust for the parties entitled.[3]

§ 125. The title of Bona Fide Purchasers for value, at sales of Collateral Securities.—Upon a sale of negotiable collateral paper, whether coupon bonds, bills of exchange, or promissory notes, made in good faith, by the pledgee, in pursuance of a valid contract of pledge, a bona fide purchaser thereof for value is vested with an unimpeachable title to such collateral securities as against all parties. No relation of pledgor and pledgee exists

[1] McCurdy's App. 65 Pa. St. 290; Jesup *v.* City of Racine, 14 Wis. 331; Ackerson *v.* Lodi Branch R. R. Co., 28 N. J. Eq. 542.

[2] Duncombe *v.* N. Y. etc. R. R. Co., 84 N. Y. 190; s. c. 88 Ib. 1; Jesup *v.* City of Racine, supra; Ackerson *v.* Lodi Branch R. R. Co., supra. The same rule as to amount of recovery was enforced where a person, authorized to raise money for the use of the company on its negotiable bonds, raised funds on his individual note, pledging the bonds as collateral, the money being applied to the use of the corporation. Rice's App, 79 Pa. St. 168.

[3] Jerome *v.* McCarter, 94 U. S. 734; Rice *v.* Southern R. R. Co., 9 Phila. 294.

between the pledgor who has permitted his collaterals to be sold upon default, and the purchaser, who has paid value therefor at such sale; nor is there any privity of contract between them, nor the assumption by the purchaser of any of the duties of a trustee in relation thereto. The bona fide purchaser for value acquires at such sale the title of the pledgor absolutely, and the negotiable collateral paper being under-due, takes the same free from antecedent equities.[1] The fact that the negotiable collateral securities sold for less than the amount due thereon is immaterial, as affecting the title of the purchaser, if the sale be valid and the purchase made in good faith and for value.[2] Upon a valid sale of negotiable bonds, held as collateral security, purchasers thereof, for value, in good faith, are bona fide holders for value for the full face of such collateral paper, although the amount of the principal debt for which the collateral security was given is less than the value of the bonds at the time of the sale.[3] Where, however, the purchaser is chargeable with notice that the sale of such negotiable collateral securities is fraudulent and unauthorized, he can acquire no rights or title as against the defrauded pledgor, although the pledgee offered such collateral notes for sale, as the indorsee with full title.[4]

§ 126. The Pledgee as purchaser of Negotiable Collateral Paper.—Where, upon a sale of negotiable collateral paper by a pledgee, without authority, the pledgee himself becomes the purchaser thereof, the relations of the parties to the contract of pledge are not affected. The pledgee is not permitted by such an act to change his

[1] Lewis *v.* Mott, 36 N. Y. 395; Duncomb *v.* N. Y. etc. R. R. Co., 84 Ib. 190; Union Trust Co. *v.* Rigdon, 93 Ill. 458; Stokes *v.* Frazer, 92 Ill. 428; Newport Bridge Co. *v.* Douglas, 12 Bush, 673; White Mountain R. R. Co. *v.* Bay State Iron Co., 50 N. H. 57; Jerome *v.* McCarter, 94 U. S. 734, 739; Allen *v.* Dallas Ry Co., 3 Woods C. C. 316.

[2] Zimpleman *v.* Veeder, 98 Ill. 613.

[3] Jerome *v.* McCarter, 94 U. S. 734.

[4] Goldsmith *v.* Trustees, 25 Minn. 202.

relations with the pledgor from that of a pledgee, under obligations, upon payment to re-deliver such collateral securities at once, to the favored position of a bona fide purchaser for value, with an absolute title thereto. The pledgor, whether such sale would have been beneficial to him or not, is entitled to regard the possession of the pledgee, under such sale and purchase, as in continuance of the pledge relations of the parties.[1] But a pledgee was allowed to become a purchaser of negotiable bonds where such bonds having been pledged by agreement, a judgment was also entered upon the secured and other indebtedness of the pledgor, and the bonds were sold under an execution levied thereunder.[2] And also in a case where upon a bill in chancery for relief it was shown that the collateral security was a long-time railroad bond, and that enough would not be realized at a judicial sale to pay the principal debt, the pledgee was allowed to become the purchaser in order that he might not be forced to part with his security.[3]

[1] Walker *v.* Castle, 97 Ill. 582; Stokes *v.* Frazier, 72 Ill. 428; Strong *v.* Nat. Bank, 45 N. Y. 718; Bank *v.* Dubuque Railroad Co., 8 Iowa, 277; Killian *v.* Hoffman, 6 Bradw. 200.

[2] Sickles *v.* Richardson, 23 Hun. 559.

[3] Carter *v.* Wake, L. R. 4 Ch. D. 605.

CHAPTER XIII.

THE PLEDGOR'S RIGHTS AS TO COLLATERAL SECURITIES.

§127. The pledgor's transfer or repledge of collateral securities.
128. Pledgor entitled to surplus proceeds from collaterals.
129. And to collateral securities upon payment or tender of debt.
130. The re-delivery of collateral securities to the pledgor
131. The pledgor's remedy upon conversion of collaterals by pledgee.
132. Relief of the pledgor in equity.
133. Equitable conditions of such relief.

§ 127. THE PLEDGOR'S TRANSFER OR RE-PLEDGE OF COLLATERAL SECURITIES.—The pledgor of negotiable instruments as collateral security, although he has indorsed the same to the pledgee so as to pass the legal title thereto, retains such a residuary interest therein that in cases where such collateral paper is of greater value than the debt he may make a further disposition of them by pledging the same for another loan, and the rights thus acquired are protected. Where the indorsement of such negotiable collateral notes has been made by the pledgor in blank, and they remain so indorsed in the hands of the pledgee, the pledgor is permitted to make a further transfer by special indorsement to a third party, who is entitled to maintain an action thereon in his own name as indorsee, upon his discharge of the debt for which the notes were held as collateral security before obtaining judgment.[1] A re-pledge of the collateral securities by the pledgor binds the pledgee, upon notice, as to any surplus after the repayment of his own advances.[2] Where collateral notes were transferred for a

[1] Fisher *v.* Bradford, 7 Greenl. 28; Pierce *v.* Kearney, 5 Hill, 92; Thompson *v.* Hewitt, 6 Ib. 254.

[2] Whitaker *v.* Sumner, 20 Pick. 405; Ferguson *v.* Union Furnace Co., 9 Wend. 345; Sanders *v.* Davis, 13 B. Mour. 342. See Hartley *v.* Russell, 2 Sim. & S. 214.

loan for less than half their value, and the pledgor made a repledge of the same for another loan, and the maker died and the pledgor became insolvent, the first pledgee, having foreclosed the title of the second pledgee, and the pledgor's trustees having disclaimed, was allowed to prove for the full face of the collaterals against the maker's estate, the actual recovery to be limited to the amount due on the principal debt, interest, and costs.[1]

§ 128. The Pledgor entitled to surplus proceeds from Collateral Securities.—Where the collateral securities deposited by the pledgor for his principal note are greater in amount than the note, and the pledgee has collected the same by suit or in some other manner has realized the value thereof, the pledgor is entitled to the surplus remaining after the payment of the debt and proper charges in and about the collection of the securities. This residuary interest of the pledgor in the collateral notes is sufficient, where the act of the pledgee is a valid realization of them, to sustain an action for the surplus as for money had and received to his use. Where the act of sale is a tort, the action may be for conversion of the collateral notes, and the damages recovered will be subject to the set-off of the amount of the debt; or the tort may be waived, and the other action brought.[2] Demand should be made for the surplus, as interest thereon will otherwise only run from the time of the service of the summons in the action for money had and received.[3] A government bond, payable in fourteen years, was pledged as collateral security for a negotiable note for the same amount, due in three months. The note not being paid at maturity, the pledgee continued to hold the collateral bond until the note was outlawed;

[1] In re Burrell, L. R. 7 Eq. 399.

[2] Thayer *v.* Mann, 19 Pick. 535; Hancock *v.* Franklin Ins. Co., 114 Mass. 155; Hunt *v.* Nevers, 15 Pick. 500; Overstreet *v.* Munn, 36 Ala. 666; Hauser *v.* same, 43 Ga. 415; Rice *v.* Benedict, 19 Mich. 132; Rohrle *v.* Stidger, 50 Cal. 207; Hilton *v.* Waring, 7 Wis. 492.

[3] Hunt *v.* Nevers, 15 Pick. 500.

but shortly before the maturity, the pledgor tendered the amount of his note in currency and demanded his collateral bond. The pledgee refused to deliver, and at its maturity, collected the bond in gold, then worth $1.74 in currency. The pledgor brought an action for money had and received, and was given a judgment for the surplus, after paying the debt.[1]

§ 129. And to Collateral Securities upon payment or tender of Debt.—The pledgor is entitled to a re-delivery of the collateral securities deposited by him, upon payment of the principal debt, or a tender thereof.[2] After such payment or tender, the pledgee has no authority to transfer such securities. The debt being discharged, his interest therein is at an end.[3] The pledgor is also entitled to a re-delivery of collaterals upon a mutual rescission of the contract;[4] but a mere offer to pay, without an actual tender, is not sufficient to entitle the pledgor to bring an action to recover such collateral securities.[5] And if upon suit, reliance is placed upon a tender of the principal debt, the pledgee is required to keep the tender good by paying the money into court.[6] The rule does not apply in the case of a wrongful sale of such collateral securites by the pledgee. The pledgee having already received the pro-

[1] Hancock *v.* Franklin Ins. Co., 114 Mass. 155.

[2] Whipple *v.* Blackington, 97 Mass. 476; Hale *v.* Rider, 5 Cush. 231; Bowditch *v.* Green, 3 Met. 360; Bank of Rutland *v.* Woodruff, 34 Vt. 89; Benon *v.* Paquin, 49 Ib. 199; Spalding *v.* Bank, 9 Pa. St. 28; Stuart *v.* Bigler, 98 Ib. 80; Farwell *v.* Importers' Nat. Bank, 90 N. Y. 483, 489; Wilson *v.* Little 2 Ib. 448; Lewis *v.* Mott, 36 Ib. 402; Ocean Nat. Bank *v.* Faut, 50 Ib. 477; Mc Lean *v.* Walker, 10 Johns. 471; Overstreet *v.* Munn, 36 Ala. 649; Overlock *v.* Hills, 8 Me. 383; G. & S. W. R. R. Co. *v.* Stahl, 103 Ill. 67; Schoole *v.* Sall, 1 Sch. & Lef. 176; Merchants' Bank *v.* Maud, 18 W. R. 312. See Walker *v.* Jones, L. R. 1 P. C. 50.

[3] Bowditch *v.* Green, 3 Met. 80.

[4] Burlingame *v.* same, 7 Cow. 92; Rice *v.* Peet, 15 Johns. 503.

[5] Lewis *v.* Mott, 36 N. Y. 402; Strange *v.* Blake, 46 Barb. 222; Bateman *v.* Poole, 15 Wend. 637; Edmundson *v.* McLeod, 16 N. Y. 543; Talty *v.* Freedmen's Trust Co., 93 U. S. 321.

[6] Smith *v.* Felton, 85 Ind. 223.

ceeds of such securities, to require a tender of the principal debt before action on the tort would be useless, as the amount of the debt is usually deducted from the damages.[1] Where a creditor accepts collateral security from an administrator without knowledge of the insolvency of the estate, he is not required to re-assign, and accept a dividend, upon the estate proving insolvent.[2]

§ 130. The re-delivery of Collateral Securities to the Pledgor.—A pledgee may, upon agreement or at his pleasure, re-deliver collateral securities to the pledgor without affecting his right to proceed upon the original demand, even although there are other creditors to whom nominally the pledgee occupies the relation of trustee, if there be no violation of his duty in that character.[3] Upon a relinquishment of securities, it is not champerty, where a debtor gives to the creditor a lien on other securities in the hands of a third person, with authority to sue the latter, and agreeing to use his best endeavors to assist in adjusting his accounts with the holder and in recovering his securities. The transaction is simply an assignment of an equity of redemption in such securities in exchange for the prior securities surrendered.[4] Where bonds were pledged as collateral security, and upon maturity, the pledgee received other collateral securities for a valuable consideration, upon an agreement to surrender the bonds, and no demand was made therefor, and no opportunity given for re-delivery, the pledgee was not answerable for a subsequent depreciation in the value thereof, while in his possession.[5]

§ 131. The Pledgor's remedy upon conversion of Collaterals by Pledgee.—After a wrongful sale by the

[1] Fletcher *v.* Dickinson, 7 Allen, 23.
[2] Kittera's Est., 17 Pa. St. 416; Strange *v.* Adams, 30 Vt. 220.
[3] In re Dyott's Est. 2 W. & S. 463.
[4] Hartley *v.* Russell, 2 Sim. & S. 244.
[5] Williamson *v.* McClure, 37 Pa. St. 402.

holder of negotiable paper as collateral security, the pledgor is entitled to his action of tort against the wrong-doer. Nor is he required, as a preliminary to the commencement of the same, to tender the amount due nor demand a return of the securities, in case where by the tortious sale the pledgee has realized more than enough to pay the debt of the pledgor. Under such circumstances, a tender of the amount of the principal notes would be a useless ceremony.[1] Where the pledgee has sold the whole of such marketable securities at a sacrifice, when a partial sale would have realized enough to have discharged the indebtedness for which they were held as collateral security, he may be required to replace those sold in excess; or, if the pledgor has bought other securities in its place, may be required to pay, as damages, the difference between the price for which the excess sold, and that paid by the pledgor to replace it.[2] The acceptance by the pledgor of the surplus arising from an illegal sale is no waiver of the right to damages arising from the sale.[3] But the tort may be waived, and the sale ratified, and by an action for money had and received, the pledgor may recover any surplus remaining in the hands of the pledgee after the satisfaction of the debt.[4]

Where, pending suit upon the principal note, the pledgee, without the knowledge of the pledgor, sells the collateral securities for the amount of the debt, but gives no credit therefor, the pledgor having paid the judgment upon the principal note, is entitled to recover from the pledgee the amount received by him upon such sale.[5] Nor will it be any defense to an action for the conversion of bonds held as collateral security, where a tender of payment of the debt and demand for the return of the collaterals had been made, that afterwards the pledgor used the money and failed to bring it into court, as the amount due and tendered would

[1] Fletcher *v.* Dickinson, 7 All. 23; Cortelyou *v.* Lansing, 2 Caines' Cas. 203.

[2] Fitzgerald *v.* Blocker, 32 Ark. 742.

[3] Ibid.

[4] Hancock *v.* Franklin Ins. Co., 114 Mass. 155.

[5] Dorrill *v.* Eaton, 35 Mich. 302.

necessarily be deducted and allowed to the defendant in fixing the amount of damages.[1] The same sale of damages, the value of the collaterals at the time of conversion, less the amount of debt, was approved in a Massachusetts case.[2]

The circulating bills of a bank were pledged as collateral security for a loan, under an agreement that they should not be put into circulation until default. Soon after default, the pledgee still holding the bills, the bank became insolvent, but the pledgee, having knowledge thereof, sold the bills, without notice to the bank or its receiver, and then claimed the balance of the loan from the assets of the bank, and the holders of the bills also filed claims. The sale of the bills being unauthorized, the rule of damages applied was the actual injury suffered, being the amount of dividends paid the holders of the bills, which was applied in reduction of the claim of the pledgee upon the original loan.[3]

§ 132. Relief of Pledgor in equity.—Equitable aid and relief is usually extended to the pledgor of negotiable instruments, where he seeks, upon proper terms, to redeem collateral securities, and the transactions between the parties to the contract of pledge, and third persons interested, are complicated, or it is sought to avoid a multiplicity of suits, or upon any other recognized head of equity jurisprudence.[4] A court of equity will take jurisdiction of such matters upon the ground that such collateral securities constitute a trust fund, and that it has jurisdiction to order an account thereof, to convert the securities into cash, and distribute the proceeds arising

[1] Wyckoff *v.* Anthony, 90 N. Y. 442.

[2] Hancock *v.* Franklin Ins. Co., 114 Mass. 155.

[3] In re Litchfield Bank, 28 Conn. 595.

[4] French *v.* Gibbs, 105 Ill. 523; Hasbrouck *v.* Vandervoort, 4 Sandf. Sup. Ct. 74; Hart *v.* Ten Eyck, 2 Johns. Ch. 100; Conyngham's App. 54 Pa. St. 474; Stephens *v.* Hartley, 2 Mont. 504; Cole *v.* Whitman, 10 Conn. 121. See Talty *v.* Freedmen's Savings Co., 93 U. S. 321, 326.

from the sale. Especially is this the case where there is, in the contract of pledge, no time set for the repayment of the loan, and several years have elapsed since the completion of the transaction in which the pledge of collaterals was made.[1] A bill for an accounting, and for redemption of pledged collaterals, was sustained after a lapse of fifteen years and a colorable sale of the property under foreclosure of the mortgages executed to secure the payment of the bonds given in pledge.[2]

In cases in which no time has been fixed by the contract of pledge of collateral securities, within which the pledgor shall have the right of redemption, the time of redemption, where a bill in equity to redeem has been filed by the pledgor, is not tolled by the statute of limitations upon the debt, since equity will render a decree to do justice between the parties irrespective of the statute.[3] A bill in equity to redeem collateral securities, brought after a lapse of seven years, the securities having then very greatly increased in value, was not approved.[4] Nor where the pledgee's possession had continued for so long a time as to raise a presumption that the pledgor had relinquished his title in satisfaction of his debt.[5] The pledgor and his representatives may be barred by *laches* where their rights are dependent upon compliance with statutory provisions, or controlled thereby.[6]

§ 133. EQUITABLE CONDITIONS OF SUCH RELIEF. —A court of equity will not lend its aid to a pledgee of collateral securities, where there has been a want of com-

[1] Stokes *v.* Frazier, 72 Ill 428, although a fear was expressed that it was carrying the jurisdiction of a court of equity to its "furthest limits."

[2] White Mountain R. R. Co. *v.* Bay State Iron Co, 50 N. H. 57.

[3] Kemp *v.* Westbrooke, 1 Ves. Sen. 278 (Lord Chancellor Hardwicke.)

[4] Lockwood *v.* Chaustilet, 1 Mod. 278; Lockwood *v.* Ewer, 2 Atk. 303.

[5] White Mountain R. R. *v.* Bay State Co., supra.

[6] International Bank *v.* Jenkins, 104 Ill. 143; Cleveland *v.* Borem, 24 N. Y. 613; Gifford *v.* Holmes, 98 U. S. 252.

pliance with the terms of a statute requiring, to validate the contract of pledge, delivery to and continued possession by the pledgee of negotiable securities. In such a case equity will not consider as done what the parties intended to do, so as to complete the transfer of title. Such equitable powers will not be exercised, to the injury of third persons, who have suffered detriment and acquired consequent rights by reason of such failure to comply with the statutory requirements.[1] Nor will it restrain the collection of a judgment on the principal debt to the amount of a draft pledged as collateral security therefor, which was given for accommodation, and the parties to which had become insolvent, and relief is sought seven years after the protest of the collateral bill.[2] Relief in equity will only be given upon the principle that "he who asks equity must do equity," so that a bill in chancery for the return of collaterals will not be sustained unless the debt has been paid, or a tender made,[3] following the rule at common law that nothing short of an actual payment or tender of the debt will entitle a pledgor to a return of the collateral securities.[4] Where negotiable promissory notes or other negotiable securities are pledged to secure the payment of a specific debt, a bill to redeem is sustained, upon payment of such debt, although the pledgee have other demands against the pledgor.[5]

[1] Casey *v.* Cavaroc, 96 U. S. 467.

[2] Compton *v.* Blair, 46 Mich. 1.

[3] Creswell *v.* Lanahan, 2 MacAr. 484; Duncombe *v.* Railroad Co., 84 N. Y. 190; s. c. 88 Ib. 1.

[4] Jones *v.* Merchants' Bank, 4 Robt. 221; 6 Ib. 162.

[5] Brown *v.* Runals, 14 Wis. 693; Vanderzee *v.* Willis, 3 Brown's Ch. 20.

CHAPTER XIV.

USURY, AS APPLIED TO COLLATERAL SECURITIES.

§134. Usury, as applied to negotiable collateral paper.
135. The rule as to collateral securities.
136. The pledgee, not entitled to collect collateral accommodation paper on usurious loan.
137. No enforcement of collateral securities upon void usurious loan.
138. Estoppel of borrower on usury, by his affirmative acts.
139. Recovery of National Banks on collateral securities for usurious loans.
140. When usury not available as a defense to collateral paper.
141. Usury not affected by taking new securities.
142. Revival of original valid debt, where new securities usurious.

§ 134. Usury, as applied to negotiable Collateral Paper.—The rights and remedies of the holder of negotiable securities, given upon a loan tainted with usury, are generally the subject of statutory regulation. The effect of such usury in the transaction of loan is, under some statutes, to render the entire contract, and the negotiable notes given in connection therewith, absolutely void, and therefore incapable of enforcement in the hands of any holder, even for value. More generally, where an actual loan of money has been made, of which the maker of negotiable promissory notes tainted with usury, had and retains the benefit, he is required to pay the valid portion of his debt, the penalty, upon proof of usury, being a forfeiture either of all interest, or of double the amount of the usurious interest, or such other penalty as is consistent with the theory that usury renders a contract of loan not void, but voidable. The like rules prevail as to the rights and remedies of the lender as to negotiable collateral paper, made by third parties, given to secure the payment of usurious

loans. Where the principal note is void because of usury, the pledgee can acquire no greater or better title to the collateral securities, given for its payment, the indorsement thereof being as void as the making of the principal notes. Where the more equitable rule prevails, the pledgee is allowed to enforce the payment of the collateral notes, where received before maturity, for an advance, without notice, given upon an usurious loan, as any other holder for value, in the usual course of business. A loan must be in contemplation of the parties, and the contract between them must be to pay a greater interest than the law allows, to constitute usury. Where such is the contract, it is immaterial that the illegal interest is secured by an independent instrument, or is included in the amount of the principal note.[1]

§ 135. The rule as to Collateral Securities. —As between parties to a contract of loan tainted with usury, the illegal consideration affects the title of the lender as well to the negotiable collateral securities received as to the principal note given for the loan. The title of the pledgee to the collateral incident is not more favored than to the principal evidence of the debt. Where the latter is declared void by statute, the pledgee, although holding the negotiable collateral paper by indorsement so as to become a party thereto, is not allowed to retain such securities as against the pledgor, the indorsement being void under such statutes, nor to enforce them as against the parties thereto.[2] The in-

[1] Nichols *v.* Fearson, 7 Pet. 103; Postlewait *v.* Garrett, 3 T. B. Mour. 345; State *v.* Boatmen's Savings Inst. 48 Mo. 189; Motte *v.* Darrell, 1 McCord, 350; Leonard *v.* Cox, 10 Neb. 542; Clark *v.* Badgeley, 9 N. J. L. 233; White *v.* Wright, 3 B. & C. 273; Sheldon *v.* Haxtun, 91 N. Y. 124; Siegert *v.* Hamel, Ib. 752.

[2] Corcoran *v.* Powers, 6 Ohio St. 19; Marks *v.* McGhee, 35 Ark. 217; Ramsdell *v.* Morgan, 16 Wend. 574; Dean *v.* Howell, Hill & D. 39; Fish *v.* DeWolf, 4 Bosw. 573; Western Reserve Bank *v.* Potter, Clarke's Ch. 432; DeWitt *v.* Brisbane, 16 N. Y. 651; Saltmarsh *v.* Tuthill, 13 Ala. 410; Carlisle *v.* Hill, 16 Ib. 406; Gaither *v.* Farmers' & Mech. Bank, 1 Peters, 37; Harrison *v.* Hamell, 5 Taunt. 780.

cident falls with the principal, and as the debt is illegal and void, no title is acquired to the collateral securities which can exclude the equitable rights of third persons.[1] A bill in equity may be brought to compel the surrender of such collateral securities pledged for the payment of an usurious debt,[2] or an injunction will be issued to restrain the pledgee from selling the same, or to stay an action thereon.[3]

Where the contract for loan, represented by the borrower's personal obligation, does not disclose usury, and a voluntary deposit of negotiable collateral paper to secure payment thereof has been made, in the absence of statutory provision making such loan void, the pledgor is required to repay the money actually loaned, with legal interest, before entitled to the aid of a court of equity to obtain a return of the collateral securities.[4] If the borrower shall have repaid the money obtained upon a usurions loan, although the contract was void, neither the borrower, nor his representatives, can recover at law the principal debt and illegal interest paid, although a court of equity would require the illegal interest to be returned.[5] Payments of such interest are generally applied in discharge of the principal debt.[6] Where negotiable collateral paper, to a large amount, was pledged to secure the payment of promissory notes created upon a loan of

[1] Bailey *v.* Smith, 14 Ohio St. 396. Usury in a debt secured by mortgage does not affect the validity of the mortgage, and is not available in defense of an action at law founded thereon. Kelly *v.* Mobile etc. Assn. 64 Ala. 501.

[2] Peters *v.* Mortimer, 4 Edw. Ch. 279.

[3] Caldwell *v.* Warehouse Co., 1 Hun, 718; Peters *v.* Mortimer, supra.

[4] Causey *v.* Yates, 6 Humphr. 60; King *v.* Green, 6 Allen, 139; Astley *v.* Reynolds, 2 Stra. 915; Fitzroy *v.* Gwillim, 1 Term R. 153.

[5] Tiffany *v.* Boatmen's Inst. 18 Wall. 375.

[6] Moniteau Nat. Bank *v.* Miller, 73 Mo. 187; Bank *v.* Slemmons, 34 Ohio St. 142; In re Wild, 11 Blatchf. 243; Overholt *v.* Nat. Bank, 82 Pa. St. 490. But where a party has given a note, secured by mortgage, a subsequent grantee of the land, in redeeming, is not allowed to deduct any usurious interest paid by his grantor, but may defend against such interest remaining unpaid. Perrin *v.* Poulson, 53 Mo. 309.

money, upon an agreement that the proceeds of the collateral notes should be applied in payment when the principal notes became due, and before maturity a large amount was collected on the collateral notes, although such proceeds were used by the pledgee in the interval without consent, the act was not such an appropriation as to create a defense of usury as to the original note. The pledgee, having thus used the proceeds, was charged with interest.[1]

§ 136. THE PLEDGEE, NOT ENTITLED TO COLLECT COLLATERAL ACCOMMODATION PAPER ON USURIOUS LOAN.—Accommodation paper, made by a third person for the purpose of being used as collateral security for a void usurious loan, is also equally void with the principal evidences of indebtedness, and no recovery can be had by the pledgee as against the accommodation maker, or other parties thereto.[2] It is a good defense to an action by an indorsee against an accommodation indorser of a negotiable promissory note that the same was received by the indorsee as collateral security for the payment of an usurious loan between himself and the maker.[3] The rule is applied to sub-pledges of accommodation paper as collateral security for an antecedent debt, without more, where the pledgee held the paper as collateral security for a loan void by statute on account of usury. The sub-pledgee, receiving no better title (the transaction occurring in New York) than the pledgee, and the collateral note being void in the hands of the latter, no recovery can be had by the sub-pledgee.[4]

§ 137. NO ENFORCEMENT OF COLLATERALS UPON VOID USURIOUS LOAN.—The assignment of bonds and mortgages as collateral security for the payment of an illegal usurious loan, is a void transaction, and the pledgor may maintain an

[1] Morgan *v.* Mechanics' etc. Assn. 19 Barb. 584.

[2] Clark *v.* Loomis, 5 Duer, 468; Corcoran *v.* Powers, 6 Ohio St. 19.

[3] Dunscombe *v.* Bunker, 3 Met. 8; Weinser *v.* Shelton, 7 Mo. 237.

[4] Bell *v.* Lent, 24 Wend. 230.

action of trover to recover the securities.[1] A bond for four thousand dollars, secured by mortgage, was assigned with the mortgage, as collateral security for a loan of two thousand dollars, upon an usurious agreement that the pledgees should retain the interest on the four thousand dollars bond and when the full amount of the bond was paid, should pay the pledgor two thousand dollars. The pledgees, without authority, foreclosed the mortgage security, and sold the property, becoming the purchasers thereof for two thousand dollars, and subsequently selling the same for five thousand dollars. The pledgor was entitled, the assignment being void as the loan was usurious, to recover the value of the bond and mortgage at the time of the assignment.[2]

§ 138. ESTOPPEL OF BORROWER ON USURY BY HIS AFFIRMATIVE ACTS.—Where a person borrows money upon a bond and mortgage, he may deprive himself of the right to interpose the defense of usury by his own affirmative acts, as where he has given a certificate that the bond and mortgage executed by him are good and valid, and that he has no defenses, equities, or set-offs, at law or in equity. Where this has been done, if the bond and mortgage are in the hands of an innocent person who has advanced a valuable consideration thereon, without notice of equities, on the faith and credit of the representations contained in such certificate, the mortgagor is estopped to set up any defense of usury in the original transaction.[3] This rule is applied in favor of the second assignee of a bond and mortgage, receiving the same for value, even with

[1] Schroeppel *v.* Corning, 5 Denio, 236; s.c., 6 N. Y. 107; Edwards *v.* Skinning, 1 Brev. (S. C. Eq.) 549; Callanan *v.* Shaw, 24 Ia. 441; Garth *v.* Cooper, 12 Ib. 364; Tregoning *v.* Attenborough, 7 Bing. 97; Hargreaves *v.* Hutchinson, 2 Ad. & E. 12.

[2] Dalton *v.* Smith, 86 N. Y. 176.

[3] Wegh *v.* Boylan, 85 N. Y. 394; Smith *v.* Munroe, 84 Ib. 354; Ashton's App. 73 Pa. St. 153; Horn *v.* Coke, 51 N. H. 287; Ryall *v.* Rowles, 2 W. & T. Lead Cas. Eq. pt. 2, 1673.

notice, if the first assignee holds the same free from equities. His title is supported by the title of his assignor.[1]

§ 139. Recovery of National Banks on Collaterals for usurious Loans.—The provisions of the National Bank Act relative to usury, and the penalties imposed therefor, supersede the provisions of the state laws concerning usury.[2] The United States Supreme Court have refused to declare invalid the indorsement of a promissory note given to a national bank as collateral security, in a transaction of loan open to the taint of usury, as the penalty thus sought to be added was additional to those provided by the National Bank Act.[3] The right of action to recover double the amount of interest on a usurious loan to a national bank, as provided by Section 5197 of the National Bank Act, accrues upon the actual payment of the borrower of the amount of illegal interest to the bank, and can be maintained whether the debt is paid or not.[4] This right of the borrower on an usurious loan is transferred to an assignee in insolvency or bankruptcy appointed to wind up his estate.[5]

§ 140. When usury not available as defense to Collateral Paper.—A loan made under a contract

[1] Wegh *v.* Boylan, 85 N. Y. 394. The rule as to sub-assignees is enforced in Ashton's App. 73 Pa. St. 153; McConnell *v.* Wenrich, 16 Pa. St. 365; Mott *v.* Clark, 9 Ib. 405.

[2] Oates *v.* National Bank, 100 U. S. 239; Barnett *v.* National Bank, 98 Ib. 555; Farmers' Nat. Bank *v.* Dearing, 91 Ib. 29; Tiffany *v.* Missouri State Bank, 18 Wall. 409; Davis *v.* Randall, 115 Mass. 547; Central Nat. Bank *v.* Pratt, Ib. 539; Nat. Bank of Erie *v.* Brown, 72 Pa. St. 209; Wiley *v.* Sturbuck, 44 Ind. 298; First Nat. Bank *v.* Guarlinghouse, 22 Ohio St. 492; Citizens' Nat. Bank *v.* Leming, 8 Int. Rev. Rec. 132. Contra: First Nat. Bank *v.* Lamb, 50 N. Y. 95.

[3] Oates *v.* National Bank, 100 U. S. 239, 250.

[4] Monongehela Nat. Bank *v.* Overholt, 96 Pa. St. 327.

[5] Crocker *v.* Nat. Bank, 4 Dillon, 358; Wright *v.* Nat. Bank, 18 N. B. R. 87; Nichols *v.* Bellows, 22 Vt. 281; Gray *v.* Bennett, 3 Met. 522; Monongehela Nat. Bank *v.* Overholt, supra. Contra: Brombey *v.* Smith, 5 N. B. R. 152.

tainted with usury cannot be assailed by a stranger, or one not a party to it, nor claiming under the party injuriously affected by it, in cases where such contract is not absolutely void by statute but only voidable at the election of the borrower, or those privy in interest or in contract with him.[1] The rule is applied in the case of makers of valid negotiable promissory notes, pledged as collateral security on an usurious loan. The defense of usury in the original loan is not allowed to be interposed upon an action by the pledgee on the collateral note. Such makers not being either parties or privies to the loan tainted with usury, cannot litigate the validity of the indorsement under which the collateral notes are held.[2] But where such collaterals, taken on an usurious contract, are rendered void by statute, no action can be brought on the collateral notes by the pledgee, against the parties thereto, as the indorsement to him is also void.[3] Although the plea of usury is a personal one, intended for the benefit of the borrower, a surety or accommodation indorser may take advantage of it.[4] Nor will the usury paid to one lender affect the claims of another lender to the enforcement of negotiable collateral paper given as security for the payment of the money loaned, where the money was obtained as one loan by a note broker for a customer, with whom the collateral notes were deposited.[5]

The defense of usury is not available to the mortgagor as against an assignee of a bond and mortgage which had been transferred under a general assignment for the benefit of creditors[6] or as collateral security for payment of a

[1] Dix *v.* Van Eyck, 2 Hill, 522; Post *v.* Dart, 8 Paige, 649; Shufelt *v.* Shufelt, 9 Ib. 145; Johnson *v.* Henry, 10 Johns. 185; Sands *v.* Church, 6 N. Y. 347; Billard *v.* Raynor, 30 Ib. 197; Billington *v.* Waggoner, 33 Ib. 31; Williams *v.* Tilt, 36 Ib. 319; Green *v.* Kemp, 13 Mass. 515; Bridge *v.* Hubbard, 15 Ib. 103; DeWolf *v.* Johnson, 10 Wheat. 367, 393.

[2] Williams *v.* Tilt, 36 N. Y. 319.

[3] Gaithers *v.* Farmers' Bank, 1 Pet. 37; Harrison *v.* Hamell, 5 Taunt. 780.

[4] Gray *v.* Brown, 22 Ala. 273.

[5] Little *v.* Baker, Hoffm. Ch. 487.

[6] Chapin *v.* Thompson, 89 N. Y. 270; Wilkinson *v.* Dodds, 1 Johns. Cas. 158; Berry *v.* Van Beuren, 17 Johns. 436.

note given by a partnership.[1] In a suit by the assignee of a bond and mortgage against the mortgagor to foreclose the security, the mortgagor is not permitted to set up usury in the transfer between the mortgagee and the assignee.[2] The rule, however, is otherwise as between the original parties.[3]

Nor will equity grant relief to a mortgagor, alleging usurious consideration in a transaction where a mortgage was given to secure the payment of a loan, against a threatened sale of the property or other enforcement thereof, except upon the equitable condition that the mortgagor shall pay to the bona fide holder of the debt, for value, the principal sum, with legal interest. His position, under such circumstances, is different from that of one defending against an usurious contract.[4] Nor can a purchaser of a mere equity of redemption in premises covered by a usurious mortgage, who purchased subject to the lien of the mortgage, set up usury as a defense thereto.[5] And where the statute upon which the defense of usury rests has been repealed, it will no longer be available to any party.[6]

§ 141. Usury not affected by taking new Securities.—The taint of usury attaching to the original evidences of indebtedness is not eliminated or defeated by the mere substitution of new securities in lieu of the old, or by renewals of the same, in which the original usurious consideration enters.[7] As between the parties, the original

[1] Stevens *v.* Reeves, 33 N. J. Eq. 427.

[2] Western Reserve Bank *v.* Potter, Clarke's Ch. 432.

[3] Hackenstein *v.* Love, 98 Pa. St. 518.

[4] Clark *v.* Finlon, 90 Ill. 248; Tooke *v.* Newman, 75 Ib. 215; Anthony *v.* Lawson, 34 Ark. 628.

[5] Pinnell *v.* Boyd, 33 N. J. Eq. 190; Dolman *v.* Crane, 14 Ib. 63.

[6] Ewell *v.* Daggs, 108 U. S. 143 (2 Sup. Ct. Rep. 408).

[7] Dunning *v.* Merrill, Clark's Ch. 252; Price *v.* Lyons Bank, 33 N. Y. 55; Tuthill *v.* Davis, 20 Johns. 285; Reed *v.* Smith, 9 Cowen, 647; Campbell *v.* McHarg, 9 Ia. 354; Torry *v.* Grant, 10 S. & M. 89; Nelson *v.* Harford, 11 Neb. 465; Moniteau Nat. Bank *v.* Miller, 73 Mo. 187; Overholt *v.* Nat. Bank, 82 Pa. St. 490.

taint of usury attaches itself as well where a further security is given or a guaranty is subsequently made, as in the case of renewal of the original note or the substitution of a new security.[1] Where parties have calculated interest upon the old securities at a higher rate than that authorized by law, and made a settlement on such basis, and the debtor gives such new notes, secured by a mortgage, for the whole sum including the illegal interest, such new notes, and the mortgage given to secure their payment, are voidable, and can not be enforced as to the excess above the legal interest.[2] But, though a past usurious contract be the basis on which the parties deal, yet if that contract be not absolutely void, a subsequent agreement which frees the transactions from all usurious taint, will be valid. A contract tainted with usury in one state may be a valid basis for a new contract in another state.[3] And where an usurious contract has been mutually abandoned, and the notes given therefor surrendered, if the parties agree upon the payment of the original loan, to the extent that it was a valid transaction, and the debtor gives new notes therefor, an action thereon by the payee is supported, as being founded upon a valuable consideration, free from the the taint of usury.[4]

§ 142. Revival of original valid debt where new Securities are usurious.—If a security founded upon a prior one be tainted with the vice of usury, and the prior

Walker *v.* Bank of Washington, 3 How. 62; Harrison *v.* Hannah, 5 Taunt. 780; White *v.* Wright, 4 B. & C. 273. Only to the extent of the usury in the old notes. Curtis *v.* Valiton, 3 Mont. 153.

[1] Bridge *v.* Hubbard, 15 Mass. 96; Brinkerhoff *v.* Foot, 1 Hoffm. Ch. 291; Powell *v.* Waters, 8 Cow. 669; Reed *v.* Smith, 9 Ib. 647; Vickey *v.* Dickson, 35 Barb. 96.

[2] Burnhisel *v.* Firman, 22 Wall. 170; Morris *v.* Way, 16 Ohio, 469; Sanford *v.* Wheeler, 13 Conn. 165; Mowry *v.* Bishop, 5 Paige, 98; Nelson *v.* Hurford, 11 Neb. 465.

[3] DeWolf *v.* Johnson, 10 Wheat. 367.

[4] Sheldon *v.* Haxtun, 91 N. Y. 124.

one free from it, but has been given up and cancelled, and the new security is thereafter adjudged void, the valid note may be revived and enforced as if the one tainted with usury had never been given.[1] Such cancellation and surrender of the prior securities under such circumstances are without consideration. If the latter securities are adjudged invalid, the creditor or pledgee has lost his debt without fault on his part, and contrary to the intent of both parties to the contract under which the change of securities took place. Upon such failure of consideration, and fraud and mistake, a court of equity will annul the cancellation and revive the securities.[2]

[1] Star *v.* Ellis, 6 Johns. Ch. 395; Loomis *v.* Hudson, 18 Iowa, 416; Hore *v.* Beecher, 12 Sim. 465; East India Co. *v.* Donald, 9 Ves. 284.

[2] Burnhisel *v.* Firman, 22 Wall. 170, 178.

PART II.

NEGOTIABLE NOTES AND MORTGAGES.

CHAPTER XV.

THE INDORSEE'S TITLE TO THE NEGOTIABLE NOTE.

§143. The negotiable note and the mortgage security.
144. The transfer of note carries mortgage security.
145. The mortgagee, as trustee for the indorsee.
146. Cases where security does not follow debt.
147. The indorsee subject to record, and should record assignment.
148. The indorsee subject to equities, under fraudulent mortgages.
149. Mistake in mortgage security, no defense against bona fide indorsee.
150. The recovery of the indorsee of mortgage notes.
151. The indorsee of mortgage notes, as affected by payments to mortgagee.
152. The indorsee of outstanding notes, when subject to payments.
153. The remedy upon the note, distinct from the security.
154. Concurrent remedies of indorsee of note and mortgage.
155. Equitable aid to the mortgagor and maker of negotiable notes.
156. The mortgage security enforced, although note barred.
157. The contra rule.
158. Application of proceeds of security to mortgage notes under priority rule.
159. Application of proceeds where, upon default, all notes become, and pro rata.
160. The equity of the assigned note preferred.

§143. THE NEGOTIABLE NOTE AND THE MORTGAGE SECURITY.—A convenient form of security for money loaned is found in the negotiable promissory note, secured by a mortgage of real estate. The note itself, being a negotiable instrument, has all the advantages of commercial paper in hands of a holder for value in good faith, and represents the

personal liability of the borrower, which can be enforced at maturity and upon default as in the case of ordinary negotiable paper. Nor does it lose its negotiable character where secured by mortgage by an indorsement and delivery thereof apart from the mortgage. The mortgage itself offers a security collateral and subsidiary to the personal obligation, of which it is an incident. In common with other collateral securities a payment of the principal note discharges the mortgage security; and if the security is foreclosed and sold, equity applies the proceeds in payment of the note. The negotiable note, received before maturity, in good faith, for value, and without notice, is free of antecedent equities, and the mortgage security, as an incident thereof, passes generally as free therefrom as the note; for the borrower, if he wishes to insist upon the equities of a non-negotiable mortgage security, should give a non-negotiable bond as representing the principal indebtedness. By indorsement of the note before maturity and assignment of the mortgage, and delivery, notes and mortgages executed by third persons, are used as collateral security for the holder's own notes and obligations. The pledgee of notes and mortgages, receiving the same without notice, is a purchaser for value, to the extent of his advances, and is entitled upon default in the negotiable paper or of the conditions of the mortgage security, to enforce such collateral securities, equally with any other bona fide indorsee and assignee for value, to the full amount thereof, irrespective of the personal evidences of indebtedness of the borrower and pledgor in his possession.[1]

[1]National Bank *v.* Whitney, 103 U. S. 99; Swift *v.* Smith, 102 Ib. 443; National Bank *v.* Matthews, 98 Ib. 621; Carpenter *v.* Longan, 16 Wall. 271; Beach *v.* Mosgrove, 16 Fed. Rep. 307; Hayden *v.* Snow, 9 Biss. 511; Wright *v.* Ross, 36 Cal. 414; Preston *v.* Case, 42 Iowa, 549; International Bank *v.* Jenkins, 104 Ill. 143; Keohane *v.* Smith, 97 Ib. 156, 159; McCracken *v.* German Ins. Co., 43 Md. 47; Pierce *v.* Faunce, 47 Me. 513; Briggs *v.* Rice, 130 Mass. 50; Smith *v.* Burgess, 133 Ib. 511; Logan *v.* Smith, 62 Mo. 455; Bell *v.* Simpson, 75 Ib. 485; National Bank *v.* Bigler, 83 N. Y. 17; Lewis *v.* Kirk, 28 Kan. 497; Wells *v.* Wells, 53 Vt.

§ 144. THE TRANSFER OF NOTE CARRIES MORTGAGE SECURITY.—The transfer of a negotiable promissory note, by indorsement and delivery, or by delivery merely, where indorsed in blank or payable to bearer, the payment of which is secured by a mortgage or deed of trust, carries with it, in equity, the mortgage or deed of trust security. The indorsee of the promissory note is entitled to the benefits of such mortgage, whether an assignment of the same is made or not[1] unless there be some special provision to the con-

1; Whiting *v.* Paul, 13 R. I. 40; Walker *v.* Lee, 14 S. C. 142; Heath *v.* Silverthorne, 39 Wis. 146.

[1] Carpenter *v.* Longan, 16 Wall. 271; Sawyer *v.* Prickett, 19 Ib. 146; Ober *v.* Gallagher, 93 U. S. 199; New Orleans etc. Co., *v.* Montgomery, 95 Ib. 16; National Bank *v.* Matthews, 98 Ib. 621; Swift *v.* Smith, 102 Ib. 443; National Bank *v.* Whitney, 103 Ib. 99, 101; Ellett *v.* Butt, 1 Woods, 220; Beals *v.* Neddo, 1 McCrary, 206; Winsted *v.* Bingham, 14 Fed. Rep. 1; Hayden *v.* Snow, 9 Biss. 511; Dickinson *v.* Worthington, 10 Fed. Rep. 860; in re Allen, 12 Ib. 433; Beach *v.* Mosgrove, (McCrary, J.) 16 Ib. 307; Foster *v.* Fox, 4 W. & S. 92; Cathcart's App. 13 Pa. St. 416; McCall *v.* Lenox, 9 S. & R. 304; Rickert *v.* Madeira, 1 Rawle, 328; Brice's App. 95 Pa. St. 105; Cullum *v.* Irwin, 4 Ala. 452; Johnson *v.* Hart, 3 Johns. Cas. 322; Jackson *v.* Willard, 4 Johns. 43; Jackson *v.* Blodgett, 5 Cow, 202; Pattison *v.* Hull, 9 Ib. 754; National Bank *v.* Bigler, 83 N. Y. 171; Howard *v.* Entreken, 24 Kan. 428; Lewis *v.* Kirk, 28 Kan. 497; Burhaus *v.* Hutcheson, 25 Kan. 631; Kurtz *v.* Sponable, 6 Kan. 395; Swenson *v.* Plow Co. 14 Ib. 388; Wellborn *v.* Williams, 9 Ga. 86; Roberts *v.* Mansfield, 32 Ib. 228; Moss *v.* Kessler, 60 Ib. 47; Whittemore *v.* Gibbs. 24 N. H. 484; Graham *v.* Newman, 31 Ala. 497; Vandercook *v.* Baker, 48 Iowa, 199; Crow *v.* Vance, 4 Ib. 434; Martindale *v.* Burch, 57 Ib. 292; Sangster *v.* Love, 11 Ib. 580; Ord *v.* McKee, 5 Cal. 616; Gay *v.* Ide, 6 Ib. 101; McMillan *v.* Richards, 9 Ib. 409; Hoffley *v.* Maier, 13 Ib. 14; Johnson *v.* Sherman, 15 Ib. 293; Lord *v.* Morris, 18 Ib. 484; McCarthy *v.* White, 21 Ib. 501; Willis *v.* Farley, 24 Ib. 490; Hurt *v.* Wilson, 38 Ib, 263; Stewart *v.* Preston, 1 Fla. 10; Johnson *v.* Carpenter, 7 Minn. 176; Humphrey *v.* Buisson, 19 Ib. 221; Hosetter *v.* Allexander, 22 Minn. 559; Ruhling *v.* Hackett, 1 Nev. 360; Sargent *v.* Howe, 21 Ill. 148; Mepps *v.* Sharpe, 32 Ib. 13; Edgerton *v.* Young, 51 Ib. 415; Kcohane *v.* Smith, 97 Ib. 156, 159; Hosmer *v.* Campbell, 98 Ib. 572, 578; Miller *v.* Larned, 103 Ib. 563; Foster *v.* Strong, 5 Bradw. 227; Anderson *v.* Baumgarten, 27 Mo. 80; Mitchell *v.* Laden, 30 Ib. 526; Green *v.* Chappell, 38 Ib. 213; Potter *v.* Stevens, 40 Ib. 229; McQuie *v.* Peay, 58 Ib. 56; Linville *v.* Savage, 58 Ib. 248; Kansas City Savings Ass'n *v.* Martin. 61 Ib. 435; Christian *v.* Newbury, Ib. 446; Logan *v.* Smith, 62 Mo. 455; Bell *v.* Simpson, 75 Ib.

trary.[1] The rule applies to a bond or other obligation given as collateral security for the payment of a promissory note.[2] It is immaterial whether the existence of the mortgage security is known to the indorsee of the note at the time of the transfer[3] so long as the same has not been separately extinguished.[4] Where part only of the evidences of indebtedness are assigned, only a *pro rata* portion of the security follows.[5] The rule applies in favor of notes given in re-

490; Croft *v.* Bunster, 9 Wis. 503; Kelley *v.* Whitney, 41 Ib. 110; Woodruff *v.* King, 47 Ib. 261; Crosby *v.* Brownson, 2 Day, 425; Pond *v.* Clarke, 14 Conn. 334; Southerin *v.* Mendum, 5 N. H. 420: Page *v.* Pierce, 26 N. H. 317, in which cases such equitable assignment was enforced in legal actions; Blunt *v.* Norris, 123 Mass. 55; Morris *v.* Bacon, 1b. 58; Bryant *v.* Damon, 6 Gray, 564; Cleveland *v.* Martin, 2 Head, 131; McCallum *v.* Jobe, 9 Baxt. 168; Paine *v.* French, 4 Ohio, 318; Swartz *v.* Leist, 13 Ohio St. 419; Duncan *v.* Louisville, 13 Bush, 385; Schmidt *v.* Frey, 5 La. Ann. 435; Pierce *v.* Faunce, 47 Me. 513; Gabbert *v.* Schwartz, 69 Ind. 450; Wright *v.* Eaves, 10 Rich. 585; Cleveland *v.* Cohrs, 10 S. C. 224; Walker *v.* Lee, 14 Ib. 142; Perkins *v.* Sterne, 23 Tex. 561; Pratt *v.* Bank, 10 Vt. 293; Keyes *v.* Wood, 21 Ib. 331; Dodge *v.* Bank, 2 MacAr. 420; Tingle *v.* Fisher, 20 W. Va. 497; Martin *v.* Moulin, 2 Burr, 979; Duffield *v.* Elwes, 1 Bl. N. S. 497; Walker *v.* Jones, L. R. 1 Pr. C. 50. In Carpenter *v.* Longan, supra, it is said: "The transfer of the note carries with it the security without any formal assignment or delivery, or even mention of the latter. If not assignable at law, it is clearly so in equity." In Boyd *v.* Parker, 43 Md. 182, where a mortgage was made to secure the indorser of a note, its benefits enured to every bona fide holder thereof. In France the mortgage security follows the instrument (Tunguier, § 75), and the Belgian code, § 26, enacts the same in express terms.

[1] Johnson *v.* Hart, 3 Johns. Cas. 322; Ellett *v.* Butt, 1 Woods, 220.

[2] Batesville Inst. *v.* Kauffman, 18 Wall. 151; Hutchinson *v.* Crane, 100 Ill. 269, 274; Wright *v.* Troutman, 81 Ib. 374.

[3] Chadwell *v.* Wheless, 6 Lea, 322; Keyes *v.* Wood, 21 Vt. 331.

[4] Logan *v.* Smith, 62 Mo. 425.

[5] Phelan *v.* Obey, 6 Cal. 478; Grattan *v.* Wiggins, 23 Ib. 16; Grapengether *v.* Fejervary, 9 Iowa, 163; Gregory *v.* Savage, 32 Conn. 250; Walker *v.* Schreiber, 47 Iowa, 529; Sample *v.* Rowe, 24 Ind. 208; Ayres *v.* Hayes, 60 Ind. 452; Duncan *v.* Louisville, 13 Bush, 378; Stockton *v.* Johnson, 6 B. Monr. 408; Noyes *v.* White, 9 Kan. 640; Brown *v.* Delany, 22 Minn. 249; Foley *v.* Rose, 123 Mass. 557; Bryant *v.* Damon, 6 Gray, 564; Bank *v.* Tarleton, 23 Miss. 173; Henderson *v.* Herrod, 10 S. & M. 631; Terry *v.* Woods, 6 Ib. 139; Stewart *v.* Crosby, 50 Me. 130; Anderson *v.* Baumgarten, 27 Mo. 80:

newal or substitution of other notes, secured by mortgage,[1] subject to proof that such notes were given in full payment of the notes secured by mortgage, in which event the security ceases.[2] While the indorsement and delivery of a negotiable promissory note, the payment of which is secured by a mortgage or deed of trust, carries with it the mortgage security, for the benefit of the indorsee for value, an assignment of the mortgage security alone, without the personal evidences of debt, conveys no right or title to the assignee, and is a nullity. The mortgage itself, without the debt to sustain it, has no reason for existence; when the debt is paid, it loses its vitality as a valid instrument. The only effect of the assignment of a mortgage by a mortgagee, where given to secure the payment of negotiable collateral notes which have passed into possession of third persons, indorsees for value, is to create a quasi or secondary trusteeship on the part of the assignee in favor of the indorsees of the paper, the payment of which is se-

Mayer *v.* Campbell, 9 Ib. 279; Stevenson *v.* Black, 1 N. J. Eq. 338; Rigney *v.* Lovejoy, 13 N. H. 247; Page *v.* Pierce, 26 N. H. 217; Pattison *v.* Hull, 9 Cow. 747; Jackson *v.* Blodgett, 5 Ib. 202; Green *v.* Hart, 1 Johns. 580; Prescott *v.* Hull, 17 Ib. 284; Beresford *v.* Ward, 1 Disney, 169; Swartz *v.* Leist, 13 Ohio St. 419; Lynch *v.* Hancock, 14 S.C. 66; Langdon *v.* Keith, 9 Vt. 299; Keyes *v.* Wood, 21 Vt. 331; Rolston *v.* Brockway, 23 Wis. 407; Batesville Inst. *v.* Kauffman, 18 Wall. 151; Martin *v.* Moulin, 2 Burr, 979. And a release of part of the debt will discharge the mortgage security pro tanto. Hawke *v.* Snydacker, 86 Ill. 197.

[1] Jones *v.* Guaranty etc. Co., 101 U. S. 622; Kuhns *v.* McGeach, 38 Ohio St. 468; Christian *v.* Newberry, 61 Mo. 446; McDonald *v.* Hulse, 16 Ib. 543; Lippold *v.* Held, 57 Ib. 213; Burdett *v.* Clay, 8 B. Monr. 287; Mc Namara *v.* Condon, 2 Mac Ar. 364; Seymour *v.* Darrow, 31 Vt. 122; Howard Bank *v.* Loomis, 51 Ib. 349; Bailey *v.* Merrick, 50 Me. 171; Verner *v.* Johns, 15 S. C. 613; Boswell *v.* Goodwin, 31 Conn. 79; Lever *v.* Bessenger, 9 Baxt. 393; Rogers *v.* Traders' Ins. Co., 6 Paige, 583; Tripp *v.* Vincent, 3 Barb. Ch. 614; Stanton *v.* Thompson, 49 N. H. 272; Taft *v.* Boyd, 13 Allen, 84; Mclledge *v.* Boston Iron Co., 5 Cush. 158; Curtis *v.* Hubbard, 9 Met. 322; Parham Mach. Co. *v.* Brock, 113 Mass. 194; Dodge *v.* Emerson, 131 Ib. 467; Washington Co. *v.* Slaughter, 54 Ib. 265; State *v.* Lake, 17 Ib. 219.

[2] Weston *v.* Wiley, 78 Ind. 54; Alford *v.* Baker, 53 Ib. 279: Lover *v.* Bessenger, 9 Baxter, 393.

cured thereby. And this trusteeship is, upon occasion, enforced by courts of equitable jurisdiction. The assignee of a mortgage security, without more, obtains no title or interest therein.[1]

§ 145. The Mortgagee as trustee for the Indorsee.—The mortgagee, or his assigns, continuing vested with the legal estate in the land, pledged for the payment of negotiable promissory notes of the mortgagor, is a trustee for any bona fide indorsee of such notes, for value, and is bound to act in good faith in his relations to him; and the indorsee has the right to control the security.[2] Ordinarily, a mortgagee is, as between himself and the mortgagor, not a trustee;[3] but a trust is raised upon the negotiation for value of the negotiable notes secured thereby in favor of the indorsee, where there is no actual assignment of the mortgage security.

§ 146. Cases where Security does not follow Debt.—The rule that the assignment of a debt will carry

[1] Carpenter *v.* Longan, 16 Wall. 271, 274; Wanzer *v.* Cary, 76 N. Y. 526; Peters *v.* Jamestown Bridge, 5 Cal. 334; Huntington *v.* Smith, 4 Conn. 235; Quniebang Bank *v.* French, 17 Ib. 134; Jackson *v.* Blodgett, 5 Cow. 205; Same *v.* Willard, 4 Johns. 43; Jackson *v.* Bronson, 19 Ib. 325; Merritt *v.* Bartholick, 36 N. Y. 44; Johnson *v.* Cornett, 29 Ind. 59; Dearborn *v.* Taylor, 18 N. H. 553; Hobson *v.* Roles, 20 Ib. 41; Hayes *v.* Lewis, 17 Wis. 212; Cleveland *v.* Cohrs, 10 S.C. 224; Perkins *v.* Sterne, 23 Tex. 561; Hamilton *v.* Lubukee, 51 Ill. 415; Grafton Bank *v.* Foster, 11 Gray, 265; Burdett *v.* Clay, 8 B. Mon. 287; Perkins *v.* Stern, 23 Tex. 563; Bayley *v.* Gould, Walker's Ch. 478; Martin *v.* McReynolds, 6 Mich. 73; Rankin *v.* Major, 9 Iowa, 297; Hill *v.* Edwards, 11 Minn. 29; Picket *v.* Jones, 63 Mo. 195; Watson *v.* Hawkins, 60 Ib. 550; Delano *v.* Bennett, 90 Ill. 533.

[2] Phelan *v.* Olney, 6 Cal. 478; Cutler *v.* Haven, 8 Pick. 490; Young *v.* Miller, 6 Gray, 152; Johnson *v.* Brown, 31 N. H. 405; Brown *v.* Blydenburgh, 7 N. Y. 141; Waterman *v.* Hunt, 2 R. I. 298; Dudley *v.* Cadwell, 19 Conn. 228; Parsons *v.* Wells, 17 Mass. 425; Sanger *v.* Bancroft, 12 Ib. 367; Swartz *v.* Leist, 13 Ohio St. 419; Johnson *v.* Carpenter, 7 Minn. 176, 184; Sturtevant *v.* Jaques, 1 Allen, 523; Torrey *v.* Dearth, 53 Vt. 331; Blumenthal *v.* Jassey, 29 Minn. 177; Lucas *v.* Harris, 20 Ill. 165.

[3] Warner *v.* Jacob, L. R. 20 Ch. D. 220.

the security given for its payment does not apply in cases in favor of indorsees of bills of exchange where a deed of trust having been given as collateral security for their acceptance, upon the bankruptcy of the acceptor, the drawer withdrew his security; nor in favor of holders of bills of exchange, where part of the land covered by a deed of trust had been released by the acceptor, and conveyed to a bona fide pledgee, as security, for a valuable consideration.[1] Nor is the mortgage security preserved in favor of a drawee of bills of exchange, where the mortgage having been made to secure the payment of certain bills which were dishonored, the drawee accepted and paid other bills of like amount, taking an assignment of the mortgage.[2] Nor in favor of a third party, where a mortgage given as indemnity to a surety upon a note made by a corporation for an advance, and the note was subsequently taken up by a third person giving his own note for the amount.[3]

§ 147 THE INDORSEE SUBJECT TO RECORD AND SHOULD RECORD ASSIGNMENT. — The duty of the indorsee of a note and mortgage is to inquire of the mortgagor if there be any reason why the note and mortgage should not be paid.[4] The indorsee is subject to any prior encumbrances appearing on record, in the direct line of the title of his mortgage security, although without notice thereof.[5] But he is not required to search the records before taking the same as security to learn if the grantor or mortgagor, or grantee or mortgagee, have made any further conveyances since the making and recording of the mortgage security. The pledgee is chargeable, as said, with notice of convey-

[1] St. Louis Building Assn. *v.* Clark, 36 Mo. 601.

[2] Wilkinson *v.* Simpson, 2 Moore Pr. Co. 275.

[3] Corbett *v.* Woodward, 5 Sawy. 403, 410.

[4] Silverman *v.* Bullock, 98 Ill. 17; Olds *v.* Cummings, 31 Ib. 188.

[5] Buchanan *v.* International Bank, 78 Ill. 500; U. S. Mortgage Co. *v.* Gross, 93 Ib. 497; Hosmer *v.* Campbell, 98 Ib. 572; Miller *v.* Larned, 103 Ib. 562, 577; Connecticut *v.* Bradish, 14 Mass. 296.

ances and encumbrances only in the direct line of the title he receives as collateral security.[1]

As between the parties, no record of any assignment of the mortgage security, given for the payment of promissory notes, is necessary; but as against third parties, even where not required by direct statutory provisions, such assignment should be placed on record, thus charging all parties dealing with the property, or negotiable securities, with notice of the rights of the indorsee and assignee. The recording of assignments of mortgages is required to protect assignees from future dealings with the property by the mortgagee and mortgagor, and third parties.[2] Nor will the record of an assignment of a promissory note and mortgage impart any validity to such assignment where there was no delivery of the securities and the same were not in the possession of the pretended assignor. The absence of possession and delivery is sufficient to put an assignee upon inquiry, and

[1] Ogle *v.* Turpin, 102 Ill. 148. A mortgagee indorsed the notes, secured by mortgage, to a bona fide person advancing value, before maturity, and delivered them with the mortgage. Subsequently, obtaining a deed of his equity from the mortgagor, he fraudulently entered a release of the first mortgage upon record, and having recorded his deed, conveyed the premises by deed of trust as security for a further loan made by parties without notice of the outstanding notes and mortgages, of which no assignment had been recorded. The second mortgagee was protected against the lien of the first notes, there being no presumption that the payee of such notes had transfered the same before purchasing the equity of redemption, and that reliance might be placed upon the record showing the release and title in the vendor.

[2] Williams *v.* Jackson, 107 U. S Rep. 478; Flower *v.* Elwood, 66 Ill 444; Ogle *v.* Turpin, 102 Ill. 148; Howard *v.* Ross, 5 Bradw. 461; Smith *v.* Keohane, 97 Ib. 156; James *v.* Johnson, 6 Johns. Ch. 417; Vanderkemp *v.* Shelton, 11 Paige, 28; James *v.* Morey, 2 Cowen, 246; Campbell *v.* Vader, 1 Abb. 295; Johnson *v.* Carpenter, 7 Minn. 183; Gregory *v.* Savage, 32 Conn. 250; Cornog *v.* Fuller, 30 Ia. 212; Bank *v.* Anderson, 14 Ib. 544; Lewis *v.* Kirk, 28 Kan. 497; Burton *v.* Baxter, 7 Blackf. 297; Hutchins *v.* State Bank, 12 Met. 424; Welsh *v.* Priest, 8 Allen, 165; Young *v.* Miller, 6 Gray, 152; Mitchell *v.* Burnham, 44 Mo. 286; Bailey *v.* Myrick, 50 Ib. 179; Warren *v.* Homestead, 33 Ib. 256; Fosdick *v.* Barr, 3 Ohio St. 371; Schwartz *v.* Leist, 13 Ib. 419; Fisher *v.* Knox, 13 Pa. St. 622; Henderson *v.* Pilgrim, 22 Tex. 464.

upon default, although advancing value, his claim is subject to prior equities of other assignees with possession, but who had not placed their assignment on record.[1]

§ 148. The Indorsee subject to equities under fraudulent Mortgages.—In the absence of judicial decisions following the rule as stated in Carpenter *v.* Longan,[2] the assignee of a non-negotiable chose in action as a mortgage or deed of trust of real estate, although receiving the negotiable evidences of the debt by indorsement, as a holder for value, in good faith, is subject to claims for recoupment or equitable set-off, where the note and mortgage or deed of trust were procured by the false and fraudulent misrepresentations of the mortgagee.[3] The like rule was applied where an indorsee of a negotiable promissory note, shown to be a forgery, sought to enforce the mortgage security, the privileges of innocent holders of commercial paper not applying in favor of an assignee of a mortgage, nor entitling him although remediless on the forged note, to enforce such mortgage security, his title under the same being subject to all defenses arising from the frauds or deceits practiced in its execution.[4] A deed of trust to secure the payment of negotiable promissory notes being fraudulent and void, bona fide indorsees of the notes for value are not allowed to enforce the mortgage security as against judgment creditors whose rights accrued prior to the indorsement of the notes.[5] Although the mortgagor is estopped to set up equities arising in the original transaction, where the mortgage security is assigned with his consent.[6] A mortgage to secure the payment of a negotiable promissory note, given for the price of liquors sold in violation of

[1] O'Mulcahy *v.* Holley, 23 Minn. 31.

[2] 16 Wall. 271.

[3] Melendy *v.* Keen, 89 Ill. 395, 404.

[4] Tabor *v.* Foy, 56 Ia. 539; Pope *v.* Jacobus, 10 Ib. 262.

[5] Potter *v.* McDonald, 43 Mo. 93.

[6] Matthews *v.* Walwyn, 4 Ves. Junr. 118; Melendy *v.* Keen, 89 Ill. 395, 404.

law, although such note and mortgage were void as between the parties[1] the note is enforced in the hands of a bona fide indorsee for value,[2] and also the mortgage, when assigned as security for its payment.[3]

§ 149. Mistake in Mortgage Security, no defense against bona fide Indorsee.—It is no defense against an indorsee before maturity of negotiable promissory notes, secured by mortgage or deed of trust, that a mistake has been made in the drafting of the mortgage deed, where such indorsee or a subsequent purchaser of the property has received the same in good faith for a valuable consideration, without knowledge of defects.[4] And such bona fide indorsee of notes so secured, for value, holding without notice of a prior equitable claim or right, may convey a perfect title to a third person having notice of such equities, since the mortgage security, once discharged of latent equities, it is immaterial whether subsequent parties receiving the same for value are chargeable or not with notice of such prior equities.[5] The rule of equitable estoppel is applied as against an owner of land, allowing the title thereto to be placed in the name of a third person, who for a long series of years is permitted to appear as its absolute legal and equitable owner. Having obtained loans from one who was without knowledge of the outstanding equity of the owner, and who advanced his money on the credit of the title of the borrower, an estoppel arose against the owner to dispute the validity of the title he has himself conferred, to the loss and hurt of an innocent pledgee for value, in the usual course of business.[6]

[1] Brigham *v.* Potter, 14 Gray, 522; Denny *v.* Dana, 2 Cush. 160.

[2] Cazet *v.* Field, 9 Gray, 329.

[3] Taylor *v.* Page, 6 Allen, 86.

[4] Carpenter *v.* Longan, 16 Wall. 271; New Orleans Canal Co. *v.* Montgomery, 95 U. S. 16; Sickmon *v.* Wood, 69 Ill. 329; Pierce *v.* Faunce, 47 Me. 507; Langdon *v.* Keith, 9 Vt. 299; *see* Drury *v.* Hayden, 111 U. S. 212, rev. s. c. 9 Biss. 511.

[5] Pierce *v.* Faunce, supra.

[6] Salter *v.* Baker, 54 Cal. 140

§ 150. The recovery by the Indorsee of mortgage Notes.—The recovery by the indorsee for value of notes, seeking in equity the enforcement of the mortgage given to secure their payment, where received in good faith, before maturity, and in the due course of business, is the full amount of such notes. Anything less would be in violation not only of the promises contained in the negotiable personal evidences of indebtedness, but of the terms of the mortgage security itself, in which is usually recited the making and delivery and form of the notes as being the consideration for the execution of the mortgage deed. Payments made by the mortgagor and maker to the mortgagee and payee, before or after the negotiation for value of such notes, secured by mortgage, are without effect as to the amount of recovery of a bona fide indorsee, before maturity of such collateral securities, for value advanced, without notice of such payments. The indorsee is entitled to recover the full amount of the notes from the mortgagor and maker, although the latter shall have paid portions of the debt before. The indorsee having the legal title to the negotiable evidences of debt, and a remedy at law, a court of equity will not interpose and take it from him. Rather, it will follow the law and allow the indorsee the benefit of the security for his bona fide advance.[1] Where, however, the promissory note, secured by mortgage, is not received so as to make the pledgee a party thereto, under proper indorsement, where required, the indorsee although advancing value takes only an equitable title to the negotiable paper, and his recovery is subject to any valid defenses the maker and mortgagor may have against the payee and mortgagee; nor is the pledgee's right increased where, after knowledge of such defenses, an indorsement of the note is obtained.[2] An attempt to transfer such negotiable paper and mortgage

[1] Carpenter *v.* Longan, 16 Wall. 271; Croft *v.* Bunster, 9 Wis. 503; Heath *v.* Silverthorne etc. Co., 39 Ib. 146. Powell, Mortg. 908.

[2] Osgood *v.* Artt, 11 Biss. (15 C. L. N. 415); Lancaster Nat. Bank *v.* Taylor, 100 Mass. 24; Whistler *v.* Foster, 14 C. B. 246.

security by an assignment and transfer thereof in a separate instrument executed for an independent purpose, is not an indorsement sufficient even to bring the assignee within the rule which admits the maker of a note to set up any valid defenses available as between himself and the payee, where it is held unindorsed by a third person, much less to entitle him to the privileges of a holder for value of negotiable paper under proper indorsement. Such assignee, in cases of fraud, want or failure of consideration, or knowledge of misappropriation, or other equity, can have no recovery either at law on the note or in equity on the mortgage security.[1]

§ 151. THE INDORSEE OF MORTGAGE NOTES, AS AFFECTED BY PAYMENTS TO MORTGAGEE.—Where a negotiable promissory note, the payment of which is secured by mortgage or deed of trust, is indorsed for value, before maturity, without notice, actual or constructive, of payments having been made thereon, the indorsee is entitled to have the mortgage security enforced for the whole amount of the note.[2] The like rule prevails, as between the maker of a negotiable promissory note, secured by mortgage executed by him, the payee and mortgagee, and the innocent indorsee of the note, before maturity, for value, as to any payments made by the maker and mortgagor to the payee and mortgagee, after the indorsement and delivery, although without notice thereof.[3] An indorsee for value of negotiable paper, secured by mortgage, is protected as against a subsequent encumbrancer, whose advances were made for the express purpose of paying off the notes secured by the first mortgage, but which

[1] Osgood *v.* Artt, supra; Melendy *v.* Keen, 89 Ill. 395, 405; Peck *v.* Bligh, 37 Ib. 117; Haskell *v.* Brown, 65 Ib. 25; Franklin *v.* Twogood, 18 Iowa, 515.

[2] Goodfellow *v.* Stillwell, 73 Mo. 17; Logan *v.* Smith, 62 Ib. 55.

[3] Burhans *v.* Hutcheson, 25 Kan. 625; Reeves *v.* Scully, Walker's Ch. 248; Dutton *v.* Ives, 5 Mich. 515; Jones *v.* Smith, 22 Ib. 360; Bank *v.* Anderson, 14 Iowa, 544; McClure *v.* Burris, 16 Ib. 591; Roberts *v.* Halsted, 9 Pa. St. 32.

were misappropriated by an agent. The second encumbrancer should have required the surrender and cancellation of the long-time notes secured by the first mortgage, or informed himself that they were in fact paid.[1] The production by a tenant of notes secured by mortgage, in an action by an assignee of the mortgage against a stranger, creates no presumption of the discharge of the mortgage, without further evidence, where it appears that the notes were not paid to a lawful holder.[2] A credit indorsed upon a note, secured by mortgage, being only a receipt, the indorsee may show the true amount paid, and recover the actual indebtedness.[3]

The rule as to releases of mortgage securities was applied where notes amounting to $25,000, secured by mortgage, were negotiated, $5,000 of them to one innocent indorsee for value, and the remaining notes to another indorsee who advanced the full value thereof upon an agreement that the mortgage should stand wholly for his benefit. A satisfaction of the mortgage for the $5,000 note was fraudulently executed by the mortgagee, without the knowledge of the mortgagors, and placed on record. The court held that nothing could defeat the rights of the innocent indorsee for value of the $5,000 note, to the proceeds of the mortgage security but such conduct on his part as to raise an equitable estoppel. His failure to give notice to the second purchaser, although aware of the terms of the sale, was not sufficient to estop him. The second purchaser was guilty of a want of care that must be regarded as equally, if not in a greater degree, as the cause of his loss, as he could have easily ascertained the facts by a little inquiry easily made. It appeared that no inquiry was ever made about the ownership of the other note, although it would have appeared that the mortgagee could not have

[1] Keohane *v.* Smith, 95 Ill. 156.
[2] Crocker *v.* Thompson, 3 Met. 224.
[3] Richardson *v.* Hadsall, 106 Ill. 476.

produced it, and that it had been negotiated to a holder for value entitled to the benefit of the mortgage.[1]

A release of record by a mortgagee, believing the notes to be paid, will not affect the right of an innocent indorsee of one or more of such notes, for value, to enforce the mortgage security.[2] Nor where, after an indorsement and delivery of negotiable bills or notes, secured by mortgage, to an innocent holder for value, the mortgagee receives full payment, executing a satisfaction on record, the mortgagor believing him to be still the holder of the notes.[3] And a purchaser, or subsequent mortgagee or trustee in a trust deed, having notice at the time of execution of their deed, that a prior mortgagee or trustee has released a mortgage or trust deed without payment of the notes or their surrender, or authority from the holder thereof, is subject to the equitable rights of the latter.[4] A mortgagee may by his representations that his mortgage has been satisfied, estop himself as against a creditor of the mortgagor, who, upon the faith and credit of such representations has accepted the mortgagor's notes in payment of the debt due, to assert that his mortgage is superior to the notes thus taken, in its lien upon the land.[5]

§ 152. The Indorsee of outstanding Notes, when subject to Payments.—Notice is not charged from a failure to demand the production of negotiable promissory notes, as against a lender of money upon other negotiable paper, secured by deed of trust, where, before advancing the money, the trustee under a prior deed of trust securing the payment of negotiable notes, and the original holder of the notes, the

[1] Smith *v.* Stevens, 49 Conn. 181 (16 Rep. 331).

[2] Martindale *v.* Burch, 57 Iowa, 291; Dickinson *v.* Worthington, 10 Fed. Rep. 860.

[3] Blumenthal *v.* Jassey, 29 Minn. 117; Mead *v.* Leavitt, 59 N. H. 476.

[4] Insurance Co. *v.* Eldridge, 102 U. S. 545.

[5] Winsmith *v.* Winsmith, 15 S. C. 611.

payee, asserted under seal in a release of their deed of trust that the first notes had been paid, and the records presented a clear title. Nor is it to be presumed that such notes under the first deed of trust were in the hands of a bona fide indorsee for value. Nothing but proof of knowledge, fraud, or gross neglect on the part of the holder of the second set of notes, would defeat his title, and his claim to priority in the distribution of the proceeds of the mortgage security.[1] The like rule was enforced where, after indorsement of the negotiable evidences of debt, a mortgagee received payment from the mortgagor, entered a release of record, and innocent parties then advanced money, secured by a new deed of trust, without notice of the fraud.[2] And also where the mortgagee had indorsed the note and mortgage as collateral security, and then released the mortgage upon record, the land passing into the hands of a bona fide purchaser for value;[3] and in favor of an innocent purchaser for value of the mortgaged premises where, through error, satisfaction had been entered of the mortgage, although some of the notes were held by indorsees for value, without notice.[4]

Money was loaned, through an agent, upon notes and mortgages, the notes being made payable to the agent, and being indorsed by him, and with the mortgage security, forwarded to the principal, the agent having authority to receive payments and to execute releases. Some of the notes and mortgages were negotiated by the principal to bona fide indorsees for value. The principal and the indorsees obtained their title subject to the defense of payment to and release by the agent. Nor was it material that, at the time of payment by the makers thereof, the agent was not in possession of the notes and mortgages.[5] And an indorsee of a negotiable note, where the deed of trust provides that payments may be made on the note to the trustee, is chargeable

[1] Williams *v.* Jackson 107 U. S. Rep. 478.

[2] Bank *v.* Anderson, 14 Iowa, 544.

[3] Lewis *v.* Kirk, 28 Kan. 497.

[4] Ayers *v.* Hays, 60 Ind. 452; Gregory *v.* Savage, 32 Conn. 250.

[5] Cowles *v.* Burns, 28 Kan. 32.

with notice thereof, and, failing to revoke such authority, is bound by any payments so made, in good faith.[1]

§ 153. The remedy upon the Note, distinct from the Security.—The liability of persons as fixed by the order of their names upon a negotiable promissory note is not changed, nor is the negotiability thereof affected, by the fact that it recites that its payment is further secured by a mortgage or deed of trust. The note still expresses the obligation of the maker to pay the sum of money mentioned therein absolutely and at all events, at maturity, to the payee or his indorsee, and lacks no essential element of commercial paper. The recital that its payment is secured by mortgage or deed of trust is not sufficient to charge third persons with knowledge of the terms of the mortgage, nor to put them upon inquiry.[2] As with other commercial paper, mere suspicion that there may be a defect in the title of the holder, or knowledge of circumstances which might excite suspicion as to his title in the mind of a prudent man, is not sufficient to defeat the title of an indorsee or holder for value. Bad faith only can do this.[3] Nor is

[1] Goodfellow *v.* Stillwell, 73 Mo. 17.

[2] Carpenter *v.* Longan, 16 Wall. 271; In re Babcock, 3 Story, 393; Crane *v.* March, 4 Pick. 131; Hale *v.* Rider, 5 Cush. 231; Ball *v.* Wyeth, 99 Mass. 338; Jackson *v.* Sackett, 7 Wend. 94; Butler *v.* Slocumb, 33 La. Ann. 170; Morris *v.* White, 28 Ib. 855; Schmidt *v.* Frey, 5 Ib. 435; Burling *v.* Goodman, 1 Nev. 314; Blumenthal *v.* Jassey, 30 Minn. (14 Rep. 52); Henry *v.* Eppinger, 34 Mich. 29, 33; Kelly *v.* Whitney, 41 Wis. 110; Bange *v.* Flint, 25 Ib. 544; Croft *v.* Bunster, 9 Ib. 503; Clark *v.* Figes, 2 Stark. 207; Wright *v.* Simpson, 6 Ves. 728. In Strong *v.* Jackson, 123 Mass. 60, the negotiable promissory note recited that it was "secured by mortgage," and was payable in five years. The Court said that such a note was not strictly "mercantile paper," in the ordinary meaning of the term; and under the circumstances of the case, which arose from the grossly fraudulent conduct of a person entrusted with the notes and mortgage, the pledgee receiving the same, although advancing value, was charged with equities of third persons not recognised in the case of the indorsement of ordinary commercial paper.

[3] Kelly *v.* Whitney, 41 Wis. 110; Cromwell *v.* County of Sac, 96 U. S. 51.

an indorsement thereof by the payee and mortgagee "without recourse" sufficient to charge an indorsee for value with notice of any defenses of the maker and mortgagor against the note, not to put him upon inquiry.[1] The mortgagee and payee, indorsing the mortgage note "without recourse" to a bona fide indorsee for value, before maturity, is liable upon his implied warranty that the amount is due as appears by the note, after deducting credits indorsed thereon. Should the mortgagee and payee, however have received rents or profits which should have been applied to the note so indorsed, but were applied to other notes and judgments against the same debtor, the mortgagee continues liable to the indorsee, upon his implied warranty, for the full sum appearing due, but has his counter remedy to recover the amounts thus applied from his debtor.[2]

The note itself, being the principal evidence of indebtedness, and having an independent vitality of its own, is not affected as a binding personal obligation of the maker, by a release of the mortgage security, or of any part thereof.[3] Nor by a dismissal of a suit brought to foreclose the mortgage security. The obligation upon the note remains.[4] Nor where the mortgage given as collateral security for its payment, is void and fraudulent,[5] nor that the mortgagor had no title to the land.[6] The indorsee of a note secured by mortgage, is not required to release his interest in such mortgage security before suing the parties in an action upon the personal evidences of debt.[7] And if in foreclosure proceedings no personal decree for the

[1] Bell *v.* Simpson, 75 Mo. 490; Stevenson *v.* O'Neal, 71 Ill. 314; Kelley *v.* Whitney, supra; Blunt *v.* Norris, 123 Mass. 55.

[2] Plain *v.* Roth. 107 Ill. 688 (15 C. L. N. 293).

[3] Edgington *v.* Hefner, 81 Ill. 341; Southerin *v.* Mendum, 5 N. H. 420; Sherwood *v.* Dunbar, 6 Cal. 53.

[4] Longworth *v.* Flagg, 10 Ohio, 300.

[5] Dorsell *v.* Mitchell, 105 U. S. 430.

[6] Krupp *v.* Krueggel, 12 Phila. 174.

[7] Hale *v.* Rider, 5 Cush. 231.

deficiency is given, the indorsee may bring his action upon the note and recover the same.[1]

§ 154. Concurrent remedies of Indorsee of Note and Mortgage.—The indorsee of a negotiable promissory note, secured by mortgage or deed of trust, is entitled, upon default, unless restricted by statutory enactment, to avail himself, at one and the same time, of his remedy by action at law upon the personal evidences of debt, and to enforce in equity his mortgage security, although with but one satisfaction of the debt.[2] Where the negotiable obligation of the debtor is secured by a deed of trust, a personal suit upon the note may be prosecuted at the same time, as the trustee exercises his power of sale under the deed.[3] Nor does it affect the right of the indorsee to enforce the mortgage or deed of trust security that the note has been merged into a judgment. So long as the judgment remains unsatisfied, the debt is unpaid, and the principal remaining, the mortgage lien is not merged, but is transferred from the note to the judgment.[4] The costs of such action at law upon the evi-

[1] Palmer *v.* Harris, 100 Ill. 276; Allen *v.* Allen, 34 N. J. Eq. 493; Marston *v.* Marston, 45 Me. 412; Bradley *v.* Chester Valley Co. 36 Pa. St. 150; Andrews *v.* Scotton, 2 Bland's Ch. 665.

[2] Ober *v.* Gallagher, 93 U. S. 208; Gilman *v.* Illinois Telegraph Co., 91 U. S. 603, 616; Eubanks *v.* Leveridge, 4 Sawy. 274; Connecticut Ins. Co. *v.* Jones, 8 Fed. Rep. 363; Chapman *v.* Lee, 64 Ala. 483; Ipswich Manuf. Co. *v.* Story, 5 Met. 312; Ely *v.* Ely, 6 Gray, 439; Longworth *v.* Flagg, 10 Ohio, 300; Baker *v.* Lehman, Wright, 522; Kansas City Savings Ass'n *v.* Mastin, 61 Mo. 435; Andrews *v.* Scotton, 2 Bland Ch. 665; Vansant *v.* Allmon, 23 Ill. 33; Edgington *v.* Hefner, 81 Ill. 341; Johnson *v.* Watson, 87 Ib. 540; Palmer *v.* Harris, 100 Ib. 276; Kellogg's case, L. R. 3 Ch. 776; Mason *v.* Bogg, 2 M. & Cr. 448.

[3] Connecticut M. L. Ins. Co. *v.* Jones, 8 Fed. Rep. 303; Vansant *v.* Allmon, 23 Ill. 30; Mester *v.* Hauser, 94 Ill. 433; Johnston *v.* Houston, 47 Mo. 230; Lichty *v.* McMartin, 11 Kan. 565; Dunkley *v.* Van Buren, 3 Johns. Ch. 330.

[4] Ober *v.* Gallagher, 93 U. S. 199; in re Kansas City etc. Co., 9 N. B. R. 76; Palmer *v.* Harris, 100 Ill. 276; Erickson *v.* Rafferty, 79 Ib. 209; Morrison *v.* Morrison, 38 Iowa, 78; Thornton *v.* Pegg, 24 Mo. 249; Zuchter *v.* Boehm, 53 Ga. 71; Connecticut M. L. Ins. Co. *v.* Jones, 8 Fed. Rep. 303.

dences of debt are a part of the mortgage debt to be recovered in foreclosure proceedings.[1] The remedies of the indorsee, at law and in equity, have been made in certain states the subject of statutory regulation, the provisions of which generally restrict the indorsee to one suit at a time, or require primary resort against the land, and restrict the recovery to an action on the note where the same has been prosecuted to judgment, and prefer equitable jurisdiction for the enforcement of such mortgage securities.[2]

§ 155. EQUITABLE AID TO THE MORTGAGOR AND MAKER OF NEGOTIABLE NOTES.—The mortgagor, who has executed negotiable notes, is given the aid of a court of equity to control the use of the mortgage security in the hands of a bare trustee, where fraud and a total want of consideration for either note or mortgage is shown. Any defenses available as against the real owner in an action upon the mortgage note are equally available in invoking the preventive powers of a court of equity against the enforcement of the mortgage to secure such note and to prevent a negotiation thereof.[3] Where a mortgagee, or his assignee, has separated the debt, represented by negotiable securities, from the mortgage security, so as to defeat the mortgagor's right to a reconveyance of the estate upon payment of the debt, a court of equity, at the instance of the mortgagor and maker of the notes, will restrain the collection of the personal evidences of debt remaining unpaid, and settle the equities of all parties.[4]

§ 156.—THE MORTGAGE SECURITY ENFORCED, ALTHOUGH REMEDY ON NOTE BARRED.—The creditor, receiving a mort-

[1] Pettibone *v.* Stevens, 15 Conn. 19.

[2] Ould *v.* Stoddard, 54 Cal. 613; Christy *v.* Dyer, 14 Iowa, 443; Morrison *v.* Morrison, 38 Iowa, 78; Brown *v.* Cascaden, 43 Ib. 103; Johnson *v.* Lewis, 13 Minn. 364; Suydam *v.* Bartle, 9 Paige Ch. 294; Williamson *v.* Champlain, 8 Ib. 70; Scofield *v.* Descher, 72 N. Y. 491; McKernan *v.* Robinson, 84 Ib. 105.

[3] Belohradsky *v.* Kuhn, 69 Ill. 547.

[4] Walker *v.* Jones, L. R. 1 Pr. C. 50; Lockhart *v.* Hardy, 9 Beav. 349; Palmer *v.* Hendrie, 27 Ib. 349; s c. 28 Ib. 341; Thornton *v.* Court, 3 De G. M. & G. 293.

gage of real estate as collateral security for the payment of a negotiable promissory note has a double remedy to recover his debt, a suit in equity to subject the land to its payment, and an action at law upon the note, and a recovery may be had on the one, although there may be some technical objection or difficulty as to recovery upon the other. The statute of limitations affecting only the remedy on the note, the debt itself which the mortgage is given to secure, remains unsatisfied, and an enforcement of the security to secure the payment of such debt is permitted upon equitable rules.[1] The like rule is applied to deeds of trust given to secure the payment of promissory notes. The security is enforced notwithstanding the bar of the statute against the note.[2] Nor will equity enjoin the sale of land under such trust deed, where the remedy on the note is barred by the statute, except upon the equitable terms of a payment

[1] Union Bank *v.* Stafford, 12 How. 340; Hughes *v.* Edwards, 9 Wheat. 489, 494; Buckner *v.* Street, 15 Fed. Rep. 365; Eubanks *v.* Leveridge, 4 Sawy, 274; Chapman *v.* Lee, 64 Ala. 483; Hall *v.* Deukla, 28 Ark. 507; Grant *v.* Burr, 54 Cal. 298; Belknap *v.* Gleason, 11 Conn. 160,166; Hough *v.* Bailey, 32 Ib. 289; Joy *v.* Adams, 26 Me. 330; Thayer *v.* Mann, 19 Pick. 535; Ipswich Manuf. Co. *v.* Storey, 5 Met. 312; Eastman *v.* Foster, 8 Ib. 19; Craine *v.* Paine, 4 Cush. 483; Lash *v.* McCormick, 17 Minn. 409; Ognum *v.* Reynolds, 11 Ib. 459; Wilkinson *v.* Flowers, 37 Miss. 579; Benson *v.* Stewart, 30 Ib. 49; Nevitt *v.* Bacon, 32 Ib. 212; Bush *v.* Cooper, 26 Ib. 599; Trotter *v.* Erwin, 27 Ib. 772; Miller *v.* Trustees, 5 S. & M. 651; Chouteau *v.* Burlando, 20 Mo. 482; Pratt *v.* Huggins, 29 Barb. 282; Heyer *v.* Pruyn, 7 Paige, 465, 470; Waltermire *v.* Westover, 14 N. Y. 19; Borst *v.* Borey, 15 Ib. 505; Cooks *v.* Culbertson, 9 Nev. 199; State *v.* Watts, 45 N. J. L. (14 Rep. 467); Fisher *v.* Mossman, 11 Ohio St. 42; Smith *v.* Washington Co., 33 Gratt. 617; Hannah *v.* Wilson, 3 Ib. 342; Richmond *v.* Allen, 25 Vt. 324; Hayes *v.* Frey, 54 Wis. 503, 519; Wiswell *v.* Baxter, 20 Ib. 680; Spears *v.* Hartley, 3 Esp. 81; Toplis *v.* Baker, 2 Cox. 123. Under the Iowa code an action to foreclose or redeem a mortgage is barred at the same time as an action at law on the debt. Smith *v.* Foster, 44 Iowa, 442; Clinton *v.* Cox, 37 Ib. 570; Brown *v.* Rockhold, 49 Ib. 282. Under the New Hampshire statute, action may be brought on the note so long as there is a right of suit on the mortgage. Colby *v.* Everett, 10 N. H. 429; Demeritt *v.* Batchelder, 28 Ib. 533.

[2] Wood *v.* Augustine, 61 Mo. 46; Grant *v.* Burr, 54 Cal. 298; Wiswell *v.* Baxter, 20 Wis. 680; Bank of the Metropolis *v.* Guttschlick, 14 Pet. 19.

or tender of the debt.[1] And a power of sale given in a mortgage continues as long as the debt remains in force and unsatisfied.[2] Even where judgment on the note has been entered, and the judgment itself is barred by the statute, the creditor is allowed, the debt not being paid, to enforce his remedy against the land.[3]

This right of the holder of a negotiable promissory note, to the enforcement of the mortgage security, is not affected by any lapse of time short of the period sufficient to raise a presumption of payment.[4] Such presumption arises generally where twenty years have elapsed since the maturity of the debt.[5] Proof is received to show a payment on account of or an acknowledgement of the debt, and to rebut such presumption.[6] Where a note payable on the day of its date, secured by a mortgage, which was not recorded for several years, and until after the death of the mortgagor, upon an action upon the mortgage security, the note being barred, brought still later, a reasonable presumption arose that the note had been paid, and a decree was refused without a production of the note, as it might have passed into the hands of a holder for value.[7]

§ 157. THE CONTRA RULE.—In three or four states, however, a different rule prevails as to the recovery of the indorsee against the mortgage security where the note itself is barred by the statute of limitations. The rule is founded

[1] Grant *v.* Burr, 54 Cal. 298.

[2] Emory *v.* Keighan, 94 Ill. 543.

[3] Hendershot *v.* Ping, 24 Iowa, 134; Morrison *v.* Morrison, 38 Ib. 73; Bank of the Metropolis *v.* Guttschlich, 14 Pet. 19, 32.

[4] Smith *v.* Washington Co., 33 Gratt. 617.

[5] Blaisdell *v.* Smith, 3 Bradw. 150; Pollock *v.* Maison, 41 Ill. 517; Jarvis *v.* Woodruff, 22 Conn. 548; Hough *v.* Bailey, 32 Ib. 289; Coolidge *v.* Larned, 8 Pick. 508; Cape Girardeau Co. *v.* Harbison, 58 Mo. 90; Giles *v.* Baremore, 5 Johns. Ch. 545; Whitney *v.* French, 25 Vt. 663; Hughes *v.* Edwards, 9 Wheat. 489; Fox *v.* Blossom, 17 Blatchf. 352; Hillary *v.* Waller, 12 Ves 239.

[6] Pratt *v.* Huggins, 29 Barb. 279; Heyer *v.* Pruyn, 7 Paige, 465; Hayes *v.* Frey, 54 Wis. 503, 519; Bank *v.* Guttschlick, 14 Pet. 19, 32.

[7] Lucas *v.* Harris, 20 Ill. 167; Carr *v.* Fielden, 18 Ib. 77, 81.

upon the theory that the mortgage security is so completely an incident of the debt it is given to secure, that the debt being barred, the mortgagee or the holder of the notes is without remedy upon the mortgage.[1] That as the note is the principal debt, that falling, the mortgage falls also; the lien created by the mortgage having expired by the death of the note, equity offers no means of reviving and enforcing it; or, in other words, where the action at law is barred by the statute of limitations, no foreclosure can be had of a mortgage given to secure its payment. The principal, having ceased to exist, the incident having nothing to which it may attach, ceases to exist also.[2] And the mortgagee cannot dispossess the mortgagor by an action of trespass to try title, or ejectment.[3] The removal, however, of the bar of the statute by some act or payment of the mortgagor and maker, revives the mortgage security, and the holder of the note is allowed to enforce the same.[4] The entry of judgment upon a note, secured by mortgage, enables the holder of the judgment to enforce the mortgage security, as against third parties, during the term the judgment continues a lien; and, as between the parties, the mortgagees or his representatives holding such judgment, the lein of the mortgage is continued, and foreclosure decreed at any time within twenty years.[5]

[1] Cunningham *v.* Hawkins, 24 Cal. 409; Swenson *v.* Plough Co., 14 Kans. 388; Chicago Lumber Co. *v.* Ashworth, 26 Ib. 212; Fort Scott *v.* Schulenberg, 22 Ib. 648; Powell *v.* Conaut, 33 Mich. 396; Lucas *v.* Harris, 20 Ill. 169; Pollock *v.* Mason, 41 Ib. 516; Lynch *v.* Swayne, 83 Ib. 336; March *v.* Mcyers, 85 Ib. 177; Emory *v.* Keighan, 94 Ib. 543; Woodward *v.* Matthews, 15 Ind. 339; Tate *v.* Fletcher, 77 Ib. 103; Duty *v.* Graham, 12 Tex. 437; Perkins *v.* Sterne, 23 Ib. 561; Ross *v.* Mitchell, 28 Ib. 150; McLane *v.* Paschall, 47 Ib. 369; Blackwell *v.* Barnett, 52 Ib. 326.

[2] March *v.* Myers, 85 Ill. 177; Lynch *v.* Swayne, 83 Ib. 336; Lucas *v.* Harris, 20 Ib. 169; Powell *v.* Conaut, 33 Mich. 396; Andrews *v.* Thayer, 30 Wis. 228.

[3] Pollock *v.* Mason, 41 Ill. 516.

[4] Duty *v.* Graham, 12 Tex. 437; Hubbard *v.* Mo. Valley R. R. Co., 25 Kan. 172; Swenson *v.* Plough Co., 14 Kan. 388.

[5] Priest *v.* Wheelock, 58 Ill. 114.

§ 158. Application of proceeds of Securities to mortgage Notes under Priority rule.—Where several notes payable at different times, made to the same payee, and representing parts of the same debt, are secured by one mortgage, in the absence of special provision, the indorsees of such notes are entitled to payment from the proceeds of the mortgaged property in the order of the maturity of such notes.[1] The legal maxim *prior in tempore, prior in jure*, is applied in such cases, as the obligation to pay the note first maturing may be enforced before default is made in later payments.[2] Such notes have been regarded as so many successive mortgages.[3] Where separate mortgages are given to secure each note, all being given for the same indebtedness, the like rule as to priority of the note first maturing is applied.[4] Priority in payment of the first note, when made the subject of clear and distinct agreement by the parties is enforced, although the mortgage security, when sold, realizes less than the whole sum of the indebtedness secured; and notice of such a contract will bind indorsees of other notes and third parties.[5] Priority may be given to the last or any

Coulter 27 Mich. 148

[1] Wilson *v.* Hayward, 6 Fla. 171; Roberts *v.* Mansfield, 32 Ga. 228; Sergeant *v.* How, 21 Ill. 148; Vansant *v.* Allen, 23 Ib. 35; Herrington *v.* McCullum, 73 Ib. 476; Koester *v.* Burke, 81 Ib. 436; Humphreys *v.* Morton, 100 Ib. 598; Harris *v.* Harlan, 14 Ind. 439; People's Bank *v.* Finney, 63 Ib. 460; Doss *v.* Ditmars, 70 Ib. 451; Shaw *v.* Newsom, 78 Ib. 335; Grapengether *v.* Fejervary, 9 Iowa, 163; McDowell *v.* Lloyd, 22 Ib. 448; Walker *v.* Schreiber, 47 Ib. 529; see Bailey *v.* Matvin, 53 Ib. 571; Richardson *v.* McKim, 20 Kan. 346; United States Bank *v.* Covert, 13 Ohio, 240; Kyle *v.* Thompson, 11 Ohio St. 616; Winters *v.* Franklin Bank, 33 Ib. 250; Mitchell *v.* Ladew, 36 Mo. 526; Ellis *v.* Lamme, 42 Ib. 153; Huffard *v.* Gootberg, 54 Ib. 271; Brown *v.* Delaney, 22 Minn. 349; Norris *v.* Beatty, 6 W. Va. 483; McClintic *v.* Wise, 25 Gratt. 448; Belding *v.* Mauley, 21 Vt. 550; Wood *v.* Trask, 7 Wis. 566; Church *v.* Smith, 39 Ib. 492; Pierce *v.* Shaw, 51 Ib. 316.

[2] Winters *v.* Franklin Bank, 33 Ohio St. 250; Wood *v.* Trask, 7 Wis. 556.

[3] Gerber *v.* Sharp, 72 Ind. 558; Murdock *v.* Ford, 17 Ib. 52.

[4] Isett *v.* Lucas, 17 Ia. 503.

[5] Shutton *v.* Wiggins, 23 Cal. 16; Wilson *v.* Hayward, 6 Fla. 171; Chew *v.* Buchanan, 30 Md. 367; Foley *v.* Rose, 123 Mass. 557; Bryant *v.* Damon, 6 Gray, 564; Langdon *v.* Keith, 9 Vt. 299; George *v.* Un-

note.[1] Such agreement, however, cannot be proven by parol testimony.[2] And the right itself, being purely equitable, in the absence of contract, may be lost by neglect, as against an innocent purchaser misled to his wrong by misrepresentations, or the wilful silence of the holder of the notes claiming such priority.[3]

§ 159. APPLICATION OF PROCEEDS WHERE, UPON DEFAULT, ALL NOTES BECOME DUE, AND PRO RATA.—The rule of applying the proceeds of mortgaged property primarily to notes first maturing, where such notes have passed into the hands of different indorsees for value, is not approved in cases where, under provisions of the mortgage, upon default of any one note all the notes become due and payable. The happening of the contingency cancels and makes nugatory the stipulations of the contract as to the times at which the notes become due, and fixes the time of payment absolutely upon default.[4] Where in such mortgage a provision is contained for an election upon the part of the payee or holder of such notes to declare the whole debt due, such election must be made, and notice given to those interested.[5]

The appropriation of the proceeds of the mortgage security to the payment of negotiable notes or bonds, where more than one are given for a single debt, and secured by the same mortgage is, in several cases, made by dividing such proceeds among the holders of the several obligations

derwood, 40 Ib. 272; Moore *v.* Ware, 38 Me. 498; Ellis *v.* Lamme, 42 Mo. 153; Bank *v.* Tarlton, 23 Miss. 173; Swartz *v.* Leist, 13 Ohio St. 419; Wooters *v.* Hollingsworth, 58 Tex. 371.

[1] Ellis *v.* Lamme, 42 Mo. 153; Brownlow *v.* Arnold, 60 Ib. 79; Walker *v.* Dement, 42 Ill. 272.

[2] Thompson *v.* Ketchum, 8 Johns. 189; Creery *v.* Holly, 14 Wend. 30; Isett *v.* Lucas, 17 Ia. 503; Hancock's App. 34 Pa. St. 155.

[3] Anderson *v.* Baumgarten, 27 Mo. 80; French *v.* Haskins, 9 Gray, 195.

[4] United States Bank *v.* Covert, 13 Ohio, 240; Pierce *v.* Shaw, 51 Wis. 316; Church *v.* Smith, 39 Ib. 492; Marine Bank *v.* Bank, 9 Ib. 57.

[5] Marine Bank *v.* International Bank, 9 Wis. 57.

pro rata.[1] The rule is properly enforced where a single mortgage is given to secure separate debts to various persons, at different times. In such cases, the liens being concurrent, no priority is allowed.[2] The rule of priority has also been held not to apply where a deed of trust was made securing negotiable coupon bonds of a railroad company, and the intention declared that there should be no sale of the mortgaged property except for the whole.[3]

§ 160. The equity of the Indorsee of assigned Note preferred.—An equity arises in favor of the indorsee, where a person holding two or more promissory notes, parts of the same debt, and secured by the same mortgage, indorses one or more thereof for value retaining the others, that, in the event of the proceeds of the security falling short of paying all the notes, the indorsed notes shall be first paid out of such proceeds, irrespective of the time of the maturity of the notes. This equity is especially favored in certain states, and is regarded as paramount to all others, and of controlling force.[4] And a note first indorsed has priority of others indorsed subsequently.[5] But this

[1] Phillips *v.* Mariner, 5 Biss. 29; Stratton *v.* Wiggins, 23 Cal. 16; Russell *v.* Carr, 38 Ga. 459; Eastman *v.* Foster, 8 Metc. 19; Goodloe *v.* Clay, 6 B. Monr. 236; Ventress *v.* Creditors, 20 La. Ann. 359; English *v.* Carney, 25 Mich. 178; Johnson *v.* Candage, 31 Me. 28; Moore *v.* Ware, 38 Ib. 496; Chew *v.* Buchanan, 30 Md. 367; Bank *v.* Tarleton, 23 Miss. 173; Davidson *v.* Allen, 36 Ib. 419; Johnson *v.* Brown, 31 N. H. 405; Stevenson *v.* Black, 1 N. J. Eq. 338; Donley *v.* Hays, 17 S. & R. 402; Perry's App. 22 Pa. St. 43; Hancock's App. 34 Ib. 155; Ellis *v.* Roscoe, 4 Baxt. 418; Andrews *v.* Hopgood, 1 Lea, 693; Smith *v.* Cunningham, 2 Tenn. Ch. 565; Waterman *v.* Hunt, 2 R. I. 298; Paris Bank *v.* Beard, 49 Tex. 358; Delespine *v.* Campbell, 52 Ib. 4; Belden *v.* Manley, 21 Vt. 551; Smith *v.* Day, 23 Ib. 662.

[2] Moffitt *v.* Roche, 76 Ind. 75; Cain *v.* Hanna, 63 Ib. 409.

[3] Humphreys *v.* Morton, 100 Ill. 598.

[4] Cullum *v.* Erwin, 4 Ala. 452; Nelson *v.* Dunn, 15 Ib. 501; Griggsby *v.* Hair, 25 Ib. 327; Roberts *v.* Mansfield, 32 Ga. 228; Richardson *v.* McKim, 20 Kan. 346; McClintic *v.* Wise, 25 Gratt. 448; Noyes *v.* White, 9 Kan. 640; Stevenson *v.* Black, 1 N. J. Eq. 338.

[5] McClintic *v.* Wise, 25 Gratt. 448.

equity of the indorsee of the transferred note is not favored in Massachusetts. A mortgagee and payee indorsed one of two notes, secured by mortgage, retaining the other, which was for a larger amount. No resulting trust, in the absence of a special agreement, was implied in favor of the indorsee as against the mortgagee that the transferred note should be first paid. The very reason of the negotiation (say the court) may have been the belief of the mortgagee that the property covered by the mortgage security was of value sufficient only to secure the payment of the note retained.[1]

[1] Young *v.* Miller, 6 Gray 152.

CHAPTER XVI.

THE INDORSEE'S TITLE TO THE MORTGAGE SECURITY.

§161. The indorsee's title to the mortgage security.
162. The rule in the United States Supreme Court—Carpenter *v.* Longan.
163. The New York view of notes and mortgages.
164. The rule in Massachusetts, New Hampshire and Maine.
165. The rule in Iowa and Wisconsin.
166. The rule in Missouri.
167. The rule in Kansas.
168. The rights of the indorsee under the rule.
169. The indorsee's title to the mortgage security, under limitations.
170. The rule in Illinois—Olds *v.* Cummings.
171. The rule in Ohio.
172. The rule in Minnesota.
173. The rule in other states.
174. The restricted rule not applied to coupon bonds or accommodation paper.

§ 161. The Indorsee's Title to the Mortgage Security.—The right of the indorsee for value of negotiable promissory notes to the enforcement of the mortgage or deed of trust security as free from antecedent equities as the note, approves itself to good judgment and natural justice. The transfer of the note by indorsement where required and delivery, before maturity, for value, in good faith and without notice, vests in the indorsee an unimpeachable title, its character as negotiable paper not being affected by the fact of its payment being secured by a mortgage or deed of trust. The indorsement of such note, and delivery, carries with it the mortgage security. The union of the two in a transaction of loan, whereby the borrower obtains money upon his principal personal obligation, supplemented by such mortgage given as security, creates the relation of

principal and incident as to the two obligations. Both being given for the same purpose, and together forming the consideration of the loan, an indorsee for value of such note and mortgage, in good faith, without notice, should not, upon plain rules of justice, be subjected in enforcing such obligations to different rules of defense, admitting equities in the case of the incident not allowed as against the principal obligation. The contract of the maker of the note is to pay the sum named therein, upon a certain day, to a person named or order, or bearer. The obligation of the mortgagor, contained in the mortgage deed, is also to pay the note upon like terms. Both engagements are the same, and the like enforcement as to each free from antecedent equities, should be given the bona fide indorsee for value. The rules of estoppel in pais are invoked against the maker and mortgagor where it is sought to assert secret equities against an innocent person who has advanced money in good faith on the credit of the representations contained in the two instruments, the negotiable note and the mortgage security. The approved rule is, that the title of the indorsee for value, in good faith, without notice of defenses, to the mortgage security is as free from antecedent equities as his title to the negotiable note, when received before maturity, under like conditions, and he is entitled equally to enforce the one as the other. This rule is followed by the Supreme Court of the United States, the federal courts, and in several state courts.[1]

[1] Carpenter *v.* Longan, 16 Wall. 271; Sawyer *v.* Pickett, 19 Wall. 147; Kennicott *v.* Supervisors, 16 Ib. 452; Batesville Inst. *v.* Kauffman, 18 Ib. 151; New Orleans etc. Co. *v.* Montgomery, 95 U. S. 16; National Bank *v.* Matthews, 98 Ib. 621; Swift *v.* Smith, 102 Ib. 442; Beals *v.* Neddo, 1 McCrary, 206; Hayden *v.* Snow, 9 Bissell, 511; Preston *v.* Case, 42 Iowa, 549; Farmers' Bank *v.* Fletcher, 44 Ib. 252; Updegraft *v.* Edwards, 45 Ib. 545; Clasey *v.* Sigg, 51 Ib. 372; Webb *v.* Haselton, 4 Neb. 318; Moses *v.* Comstock, Ib. 520; Gabbert *v.* Schwartz, 69 Ind. 450; Morgan *v.* Smith, etc. Co., 73 Ib. 179; Murray *v.* Jones, 50 Ga. 109; Paige *v.* Chapman, 58 N. H. 334; Dutton *v.* Ives, 5 Mich. 519; James *v.* Smith, 22 Ib. 360; Terry *v.* Tuttle, 24 Ib. 206; Howry *v.* Eppenger, 34

§ 162. The rule in the United States Supreme Court—Carpenter v. Longan.—The rights of the indorsee of a negotiable promissory note secured by mortgage or deed of trust, in respect to the enforcement of the mortgage security, came up for decision in the United States Supreme Court for the first time in the case of Carpenter *v.* Longan,[1] and the full court approved the rule that the

Mich. 29, 33; Kelner *v.* Krolich, 36 Mich. 373; Judge *v.* Vogel. 38 Ib. 568; Hurt *v.* Wilson, 38 Cal. 263; Malrury *v.* Rinz, 58 Ib. 11; Willis *v.* Farley, 24 Ib. 290; Ord *v.* McKee, 5 Ib. 516; Duncan *v.* Louisville, 14 Bush. 385; Lewis *v.* Kirk, 28 Kan. 497; Burhans *v.* Hutcheson, 25 Kan. 625; McCrum *v.* Corby, 11 Ib. 464; Logan *v.* Smith, 62 Mo. 455; Goodfellow *v.* Stillwell, 73 Mo. 17; Potts *v.* Blackwell, 4 Jones, 58; Crane *v.* March, 4 Pick. 131; Brown *v.* Tyler, 8 Gray, 135; Cazet *v.* Field. 9 Ib. 329; Taylor *v.* Page, 6 Allen, 86; Lane *v.* Davis, 14 Ib. 225; Boyd *v.* Parker, 43 Md. 182; McCracken *v.* German Fire Ins. Co., 43 Ib. 471; Morris *v.* Bacon, 123 Mass. 58; Montague *v.* Boston R. R. Co., 124 Ib. 242; Stevens *v.* Dedham Inst., 129 Ib. 547; Briggs *v.* Rice, 130 Ib. 50; Walker *v.* Lee, 14 S. C. 142; Croft *v.* Bunster, 9 Wis. 503; Cornell *v.* Hickens, 11 Ib. 353; Andrews *v.* Hart, 17 Ib. 306; Bange *v.* Flint, 25 Ib. 544; Heath *v.* Silverthorne etc. Co., 39 Ib. 146. A distinction is drawn between cases where a mortgage secures payment of negotiable instruments and where it secures non-negotiable, the Court applying it only in the former class. Kelly *v.* Whitney, 41 Wis. 110. The same distinction is stated in the leading case, of Carpenter *v.* Longan, supra. In McCrum *v.* Corby, 11 Kan. 464, and Walker *v.* Lee, 14 S. C. 142, the notes, although payable to order, were pledged unindorsed. The pledgees were held to take an equitable title only thereto, and to be subject to equities. Otherwise, if properly parties to the instrument. The contra view was taken in Corbett *v.* Woodward, 5 Sawy. 403, and In re Kansas City etc. Co. 9 N. B. R. 76, cases of assignment of promissory notes secured by mortgage, the latter arising under the bankrupt law; and in U. S. *v.* Sturges, 1 Paine. 534: and Fales *v.* Mayberry, 2 Gall. 564, where the evidences of debt were non-negotiable bonds.

[1] 16 Wall, 271. The facts were: Mahala Longan and Jesse B. Longan executed their negotiable promissory note to Jacob B. Carpenter, or order, for the sum of $980, payable six months after date, at a bank in Denver, with interest. At the same time Mahala Longan executed to Carpenter a mortgage upon certain real estate, conditioned for the payment of the note at its maturity. Two months before the maturity of the note it was indorsed for a valuable consideration to B. Platte Carpenter, the plaintiff. The note not being paid at maturity, suit was brought to foreclose the mortgage. The defendant set up that she had delivered wheat and flour to the original holder of the note at the time of the

indorsee takes the mortgage as he takes the note, free from antecedent equities. The opinion of the court was delivered by Mr. Justice Swayne. "The question is," say the Court, "whether an assignee, under the circumstances of the case, takes the mortgage as he takes the note, free from the objections to which it was liable in the hands of the mortgagee. We hold the affirmative. The contract, as regards the note, was that the maker should pay it at maturity to any bona fide indorsee, without reference to any defenses to which it might have been liable in the hands of the payee. The mortgage was conditioned to secure the fulfilment of that contract. To let in such a defense against such a holder would be a clear departure from the agreement of the mortgagor and mortgagee, to which the assignee subsequently, in good faith, became a party. If the mortgagor desired to reserve such an advantage, he should have given a non-negotiable instrument. 'If one of two innocent persons must suffer by a deceit, it is more consonant to reason that he who puts trust and confidence in the deceiver should be a loser rather than a stranger.' (Hern *v.* Nichols, 1 Salk. 289)." The court further say: "All the authorities agree that the debt is the principal thing, and the mortgage an accessory. Equity puts the principal and accessory upon a footing of equality, and gives to the assignee of the evidence of the debt the same rights in regard to both. There is no analogy between this case and one where a chose in action, standing alone, is sought to be enforced. The fallacy which lies in overlooking this distinction has misled many able minds, and is the source of all the confusion that exists. The mortgage can have no separate existence. When the note is paid the mortgage expires. It can not survive for a

execution of the mortgage, the proceeds to be applied in payment of the note, but that he had converted the same to his own use; and it was shown that the flour and wheat were stored in a warehouse; that some was sold, and that both goods and money were lost by reason of the insolvency of such mortgagee. No knowledge or notice of this transaction was chargeable as against the indorsee of the note.

moment the debt which the note represents. This dependent and incidental relation is the controlling consideration, and takes the case out of the rule applied to choses in action, where no such relation of dependence exists. *Accessorium non ducit, sequitur principale.*"

The rule announced has been applied in later cases by the United States Supreme Court, where the indorsement of the note and mortgage was for the purpose of collateral security for other obligations of the pledgor,[1] and in cases of deeds of trust.[2]

§ 163. THE NEW YORK VIEW OF NOTES AND MORTGAGES. — In an early New York case involving the use of indorsed negotiable notes, secured by mortgage, as collateral, Chancellor Kent, speaking of the relation between the note and mortgage, said, "Wherever the note goes, the land will go along with it. The estate in the land is the same thing as the money due on the note. By the transfer of note, the mortgage went with it, and the same interest passed in the one as in the other."[3] But promissory notes are rarely used in New York in connection with mortgage security, non-negotiable bonds being used in place thereof. In this connection, in the Trustees of Union College *v.* Wheeler,[4] (Dwight, C. J.) said, "Reference is made to a class of cases holding in substance that when a mortgage is given to secure a negotiable note, which is itself transferred before maturity, it is taken by the assignee free from all equities; and it is argued that these authorities tend to show that the mortgage partakes of the nature of the debt in such a sense that only the direct equities between the debtor and the creditor can be set up as against the assignee. These cases have not become the

[1] Sawyer *v.* Prickett, 19 Wall. 147; Kennicott *v.* Supervisors, 16 Wall. 452; National Bank *v.* Matthews, 98 Ib. 621; Swift *v.* Smith, 102 Ib. 442.

[2] New Orleans etc. Co. *v.* Montgomery, 95 U. S. 16.

[3] Johnson *v.* Hart, 3 Johns. Cas. 322, 330.

[4] 61 N. Y. 88.

established law in this state. If sound they must be made to rest on rules of law attending the transfer of negotiable paper, and cannot be held by indirection to overthrow a rule concerning the ordinary bond and mortgage which has become fixed in our jurisprudence."

§164. The rule in Massachusetts, New Hampshire and Maine.—In Massachusetts, the rule is recognised that the indorsee of a negotiable promissory note, secured by mortgage or deed of trust, takes the security as he takes the note.[1] In Taylor *v.* Page,[2] where the consideration of the note and mortgage was illegal, an indorsee of the note, for value, before maturity, without notice, was allowed to recover on the mortgage security, no principle or authority making the mortgage less valid than the note in the hands of an innocent indorsee for value. The rule has been enforced in later cases, the transfers being as collateral security.[3] In a recent case in New Hampshire,[4] upon a writ of entry upon a mortgage, by the indorsee of the note and assignee of the mortgage, who received the same for value, before due, as collateral security, in good faith, and without notice of defenses, the mortgagor was not permitted to set up any defense of want of consideration, or that the note and mortgage were obtained from him by fraudulent representations. The mortgage was enforced equally as freed from equities as the note, as "defenses (say the court) which cannot be made against the note because it has travelled away from them, cannot be made against the mortgage which has kept company with the note." In Maine, a mortgagee is pro tanto apurchaser,and a bona fide mortgagee is

[1] Crane *v.* March, 4 Pick, 131.

[2] 6 Allen, 86.

[3] Morris *v.* Bacon, 123 Mass. 58 Strong *v.* Jackson, 123 Ib. 60; Blunt *v.* Norris, 123 Mass. 55; Montague *v.* Boston R. R. Co., 124 Mass. 242; Stevens *v.* Dedham Inst. 129 Ib, 547; Brown *v.* Tyler, 8 Gray, 135; Taylor *v.* Page, 6 Allen 36; Lane *v.* Davis, 14 Ib. 225. Sub-pledgees were protected in Draper *v.* Saxton, 118 Mass. 427; Briggs *v.* Rice, 130 Ib. 50.

[4] Paige *v.* Chapman, 58 N. H. 333; Tucker *v.* Bank, Ib. 83; criticising Jenness *v.* Bean, 10 N. H. 266; Williams *v.* Little, 11 Ib. 66.

equally entitled to protection as a bona fide grantee; the assignee of a mortgage is on the same footing with the bona fide mortgagee. He relies upon the record, and is protected against unknown and latent equities.[1]

§ 165. The rule in Iowa and Wisconsin.—The question was first decided in Iowa in the case of Preston *v.* Case.[2] A negotiable promissory note, payable to the order of the cashier of a bank, and secured by a mortgage, was executed and delivered as collateral security for proposed future advances of money as they might be required. In fact, no advances were ever made. The cashier of the bank, some time after the delivery thereof, indorsed the note in blank, and forwarded it, with the mortgage, and other like securities to the Chicago correspondent of the bank as collateral security for a present loan. The pledgee, as a holder for value in good faith of the note, was allowed to enforce the mortgage security as free of equities arising from want of consideration as if the action had been on the note itself, the right of enforcement of the mortgage security following the transfer of the negotiable collateral note. The rule of Carpenter *v.* Longan, supra, has been followed in later cases.[3]

In Wisconsin, the rule was extended to include an indorsee for value of negotiable paper, secured by mortgage, in

[1] Pierce *v.* Faunce, 47 Me. 507.

[2] 42 Iowa, 549. In Judge *v.* Vogel, 38 Mich. 568, a mortgage was given for a certain sum, but really to secure future advances, of which, however, none were made. An innocent person, advancing money in good faith upon the belief and credit of the statements as to the debt contained in the mortgage, took no greater title to the security than the mortgagee, and was not allowed the aid of equity to enforce the same. The court recognize, however, that if the debt had been represented by a negotiable promissory note which had passed into the hands of an innocent indorsee for value, before maturity, without notice, he would have taken the mortgage as the note, free of pre-existing equities. Ladue *v.* Detroit R. R. Co., 15 Mich. 380.

[3] Farmers' Bank *v.* Fletcher, 44 Iowa, 252; Updegraft *v.* Edwards, 45 Ib. 545; Clasey *v.* Sigg, 51 Ib. 372; Vandercook *v.* Baker, 48 Ib. 199; Martindale *v.* Burch, 57 Ib. 291.

a case where a corporation holding the promissory note and mortgage of A, executed to C, its negotiable bond for a sum equal to the note, attaching thereto the note and mortgage, and reciting in the bond that the note and mortgage were transferred to C. as collateral security, and that both should be transferable in connection with the bond, and not otherwise. This was regarded as a sufficient indorsement within the law merchant to pass both the note and the mortgage security to the indorsee free from equities.[1]

§ 166. The Rule in Missouri.—Missouri adopted the views stated as to the rights of the indorsee of the note to the enforcement of the mortgage security in Logan *v.* Smith,[2] holding (where a negotiable promissory note secured by mortgage had been pledged as collateral security for a present loan so as to make the pledgee a party to the instrument) that an indorsee for value of a negotiable note, who receives it discharged of equities to which it was subject in the hands of the payee, acquires the same right in a mortgage given to secure it, which the payee would have had, if no equities had ever existed against the note. The rule has been enforced in a later case, in which an indorsee for value of a negotiable promissory note, secured by deed of trust, before maturity, and without knowledge of payments made upon it, was allowed to enforce the security to the full amount of the note.[3] A bank, under the form of discounting the note of a third party, took up certain notes secured by a deed of trust, in order to prevent a foreclosure, retaining the notes and mortgage as collateral security. As against the maker, the transaction amounted to a purchase, and not a payment thereof, and the bank, default having taken place in the securities, was allowed to enforce the mortgage security.[4]

[1] Crosby *v.* Roub, 16 Wis. 625.
[2] 62 Mo. 455.
[3] Goodfellow *v.* Smith, 73 Mo. 17.
[4] Swope *v.* Leffingwell, 72 Mo. 348; reversing s. c., 4 Mo. App. 525; affirmed in 105 U. S. 17.

§ 167. THE RULE IN KANSAS.—The Supreme Court of Kansas (Valentine, J.), recently, in the case of Lewis *v.* Kirk[1] announced the rule upon this subject prevailing in that state, as follows: "Where a real estate mortgage is executed to secure the payment of a negotiable promissory note, such mortgage will so far partake of the negotiable character of a note, that whenever the note is transferred by indorsement before due so as to free it from all equities existing in favor of the maker of the note, or prior indorsers, the mortgage will also be freed from such equities. Until the mortgage is recorded such transfers will not prevent a third person, who has no notice of the mortgage or transfer from purchasing the mortgaged property, and thereby obtaining a full and absolute title to the property free and and clear from the mortgage lien. But when the mortgage is recorded, its negotiable character is then extended even to bona fide purchasers of the property, and it retains such character, contemporaneously with the existence of the note to which it is an incident, until the note is satisfied, or until the mortgage is released of record by the mortgagee or his attorney, assignee, or personal representative; and that, when the mortgage is so released, it then loses its negotiable character to the extent that any third person who may then purchase the property in good faith will obtain the full, complete, and absolute title thereto, freed from all equities, liens, interests, trusts, or incumbrances existing in favor of any holder of the note and mortgage, whether the note is satisfied or not." In an earlier case, the record of an assignment of a mortgage by a bona fide indorsee for value of negotiable paper, transferred before maturity, and secured by a mortgage, was not required, nor notice to the mortgagor of such assignment, in order to protect the indorsee against payments made, after the assignment and without his knowledge or consent, by the mortgagor to the mortgagee.[2]

[1] Lewis *v.* Kirk, 28 Kan. 497.

[2] Burhans *v.* Hutcheson, 25 Kan. 625.

§ 168. Rights of the Indorsee for value under the rule.—The title of the indorsee for value, in good faith, before maturity, of a negotiable promissory note, secured by mortgage, to the enforcement of the security, is not defeated by the fraud of the mortgagee, in procuring a release of the mortgage.[1] Nor, where several negotiable notes are secured thereby, some of which had been transferred, will the release of record of the mortgage by the mortgagee, supposing the notes had all been paid, discharge the mortgage as to such of said notes as were outstanding and unpaid in the hands of bona fide indorsees for value, before maturity.[2] The title of the indorsee of the note and his right to the enforcement of the mortgage security, equally as free of equities as the note, was supported where a wife claimed that she was forced to execute the note and mortgage under threats of personal violence. Such a defense presents no superior equities to those of the bona fide indorsee of the paper secured thereby.[3] Nor can a wife question the validity of an assignment of a mortgage, given to secure the payment of a negotiable promissory note, held by an indorsee for value, upon the ground that the premises covered by the mortgage were her homestead.[4] An assignee of a mortgage executed to one with notice that it was without consideration, and that no note was ever delivered, is subject to equities between the original parties.[5] Nor does the rule of Carpenter *v.* Longan affect statutory provisions relative to priority of different mortgages; the indorsee for value of a note and mortgage is subject thereto as well as the original parties.[6]

§ 169. The Indorsee's title to the Mortgage Security, under limitations.—The right of the indorsee of

[1] Vandercock *v.* Baker, 48 Iowa, 199.

[2] Martindale *v.* Burch, 57 Iowa, 291.

[3] Beals *v.* Neddo, 1 McCrary, 206.

[4] Malrury *v.* Rinz, 58 Cal. 11.

[5] Burbank *v.* Warwick, 52 Iowa, 493.

[6] Yerger *v.* Barz, 56 Iowa, 77.

a negotiable promissory note to the enforcement of a mortgage of land given as security for its payment, is subject in certain states to limitations, which affect materially the availability of such securities, either for sale or use as collaterals. The liability of the maker or indorser upon his own personal obligation, when in the hands of an indorsee for value, before maturity, and without notice, is not questioned. The mortgage, however, being treated as in the nature of an independent contract, enforceable only in equity, the indorsee of the note, receiving the mortgage by assignment, or as an incident following the note without more, is subject generally to antecedent equities arising out of the original transaction, and as between the original parties, and in some cases to the secret equities of third persons and cestuis que trust. Although the condition of the mortgage is to pay the note, the indorsee for value seeking to enforce the same in a court of equity, is subject to all equities and defenses available to the mortgagor if sued by the mortgagee. If judgment were taken on the principal note by the indorsee, such judgment would be a lien on the mortgagor's estate (including that covered by the mortgage) for the whole amount thereof, and a court of equity would not interfere to restrain the enforcement of such judgment lien for the full face of the note. The indorsee may pursue his remedies, both at law and in equity at the same time, with the anomalous result that while his recovery at law will be as stated for the amount of the note, the decree in equity upon the mortgage security may be for a different amount, as his recovery is subject to defenses not permitted in the action at law. This inconsistency cannot occur under the rule of Carpenter *v.* Longan.

§ 170. The rule in Illinois—Olds v. Cummings.—The rule was established in Illinois in the leading case of Olds *v.* Cummings[1] in which an indorsee for value of nego-

[1] 31 Ill. 188.

tiable promissory notes, receiving the same before maturity, without notice of defenses, sought to enforce the mortgage security in equity by foreclosure and sale. Usury was set up as a defense, and also that the indorsement of the note and mortgage was only colorable, and for the purpose of cutting off defenses. In delivering the opinion of the court, Chief Justice Caton presented the argument in favor of the restricted rule. "Mortgages," he said, "are not commercial paper. It is not convenient to pass them, from hand to hand performing the real office of money in commercial transactions, as notes, bills and the like. * * * The note itself, though secured by a mortgage, is still commercial paper, and when the remedy is sought upon that, all the rights incident to commercial paper will be enforced in the courts of law. But when this remedy is sought through the medium of a mortgage; when that is the foundation of the suit, and the note is merely used as an incident, to ascertain the amount due on the mortgage, then the courts of equity, to which resort is had, must pause, and look deeper into the transaction, and see if there be any equitable reason why it should not be enforced. He who holds a note, and also a mortgage, holds in facts two instruments for the security of the debt; first, the note, with its personal security, which is commercial paper, and as such, may be enforced in courts of law, with all the rights incident to such paper, and the other, the mortgage, with security on land, which may be enforced in the courts of equity, and is subject to the equities existing between the parties. * * * The assignee is required to inquire of the mortgagor if there is any reason why the mortgage should not be paid, but he should not be required to inquire of the whole world, to see if some one has not a latent equity which might be interfered with by his purchase of the mortgage, as for instance, a cestui que trust." The rule has been followed in later cases,[1] but is not applied as against

[1] Walker *v.* Dement, 47 Ill. 273; Edgerton *v.* Young, 43 Ill. 464; Kleeman *v.* Frisbie, 63 Ib. 482; White *v.* Sutherland, 64 Ib. 181; Haskell *v.*

an indorsee for value of a negotiable promissory note, secured by mortgage, where the claim of set-off is in respect of a debt arising out of a collateral matter.[1] And where notes and mortgages are executed, and delivery is made thereof to the payee of the notes so that he may sell them upon the market to raise money for certain purposes, the mortgagee is estopped as against an indorsee for value, without notice, seeking to foreclose the mortgage security, to question its validity, although the agent misappropriated the money received.[2] The rule that a holder for value of negotiable notes and mortgage is not subject to secret equities of cestuis que trust of which he has no notice, is applied where the real owner of land has enabled his agent to sell and convey his land to a third person, who gave his notes, payable to the agent, and secured by a mortgage, and the notes passed by indorsement to an indorsee for value without notice, although the sale of the land was a fraud on the real owner.[3]

§ 171. The rule in Ohio.—In Ohio, the indorsee of a negotiable promissory note, secured by mortgage, upon enforcing in equity the mortgage security is subject not only to the equities of the original parties, but also to the equitable rights and title of third persons. In the leading case in that state,[4] the court declined to affirm, either that a mortgage, when made to secure a negotiable note, becomes, contrary to its general nature and qualities, a negotiable instrument; or, that the transfer of such a note, without

Brown, 65 Ib. 29; Thompson *v.* Shoemaker, 68 Ib. 259; Belohradsky *v.* Kuhn, 69 Ib. 547; Petillon *v.* Noble, 73 Ib. 567; Buchanan *v.* International Bank, 78 Ib. 500; International Bank *v.* Bowen, 80 Ill. 541; Darst *v.* Gale, 83 Ib. 137; Melendy *v.* Keen, 89 Ib. 395; Bryant *v.* Vix, 83 Ib. 14; Colehour *v.* State Savings Inst., 90 Ib. 152; Hosmer *v.* Campbell, 98 Ib. 573; McIntire *v.* Yates, 104 Ib. 491; Grassley *v.* Reinbach, 4 Bradw. 344; Foster *v.* Strong, 5 Ib. 227.

[1] Colehour *v.* State Savings Inst., 90 Ill. 152.

[2] McIntire *v* Yates, 104 Ill. 491; Melendy *v.* Keen, 89 Ill. 395, 403.

[3] Silverman *v.* Bullock, 98 Ill. 11.

[4] Bailey *v.* Smith, 14 Ohio St. 396.

the aid of any statute, or of any judicial decisions, except those of very recent date, has an effect upon the note itself, and draws after it, and within, one of the most important incidents of negotiability, a collateral contract having relation to the same debt. Mortgages being (the court say) "mere choses in action; and whether standing alone, or taken to secure negotiable or non-negotiable paper, they are only available for what is honestly due from the mortgagor to the mortgagee. If they are assigned, either expressly or by implication, the assignee takes only the interest which his assignor had in the instrument—acquires but an equity, and, upon the long-established doctrine of courts of equity, is bound to submit to the assertion of the prior equitable rights of third persons." The indorsee, suing upon the note, may recover judgment for the full amount thereof.[1] And where a note, payable on demand, was secured by mortgage, the mortgage became due under the same conditions as the note.[2]

§ 172. The rule in Minnesota.—In Minnesota, the rule is established that by the transfer of a negotiable promissory note, secured by mortgage, the indorsee of the note is entitled to enforce the mortgage security only as subject to equities existing between the original parties.[3] A mortgage being a chose in action, as between the mortgagor and the mortgagee, or any subsequent assignee from the latter, is taken subject to the state of accounts between the mortgagor and mortgagee at the time of the assignment, and to all payments made by the mortgagor to the mortgagee at any time before actual notice thereof.[4] And where an assignment of a note and mortgage is made by a separate instrument, the person receiving the same being chargeable with notice that they are not in possession of the assignor,

[1] Heller *v.* Meis, 2 Sup. Ct. R. 289.

[2] Union Central Life Ins. Co. *v.* Curtis, 33 Ohio St. 343.

[3] Johnson *v.* Carpenter, 7 Minn. 176; Hostetter *v.* Alexander, 22 Ib. 559; Blumenthal *v.* Jassey, 30 Minn. (14 Rep. 52.)

[4] Johnson *v.* Carpenter, supra.

but making no inquiry, the presumption in favor of purchasers in good faith, within the meaning of the registry laws, is not invoked for his protection, and his assignment, although recorded, is subject to an unrecorded assignment of the same note and mortgage, accompanied by delivery and possession.[1]

§ 173. THE RULE IN OTHER STATES.—Under the Louisiana code and the decisions of the courts of that state, the negotiability of the note secured by mortgage, so far as the personal liability of the parties thereto are concerned, to the full amount thereof, is conceded and enforced.[2] A different rule is applied to the mortgage security. A mortgage is not negotiable in the sense of the commercial law,[3] whether transferred by separate assignment, or following as accessory to the transfer of the negotiable note the payment of which is secured by it.[4] The transferree of a mortgage receives no greater right or title than the transferror has at the time the transfer is made.[5] The mortgage security vests in the indorsee of the note subject to all equities and defenses existing between the original mortgagor and mortgagee.[6] If the mortgage has been extinguished, or has for any cause ceased to be an existing obligation, and can no longer be enforced by the mortgagee, the indorsee of the note cannot enforce it.[7]

The indorsee of negotiable notes, secured by mortgage, although paying less therefor than their face, is entitled in South Carolina to the full benefits of his purchase and may recover the face value thereof. But, in resorting to the collection of his debt from the mortgage security, if the assign-

[1] O'Mulcahy *v.* Holley, 28 Minn. 31.

[2] Schmidt *v.* Frey, 5 La. Ann. 435; Garner *v.* Gay, 26 Ib. 376; Morris *v.* White, 28 Ib. 855; Butler *v.* Slocomb, 33 Ib. 170.

[3] Boligny *v.* Foster, 17 La. Ann. 121.

[4] Schmidt *v.* Frey, supra.

[5] Sprig *v.* Bossier, 5 N. S. 56; Guaton *v.* Matthews, 5 La. Ann. 495; Bouligny *v.* Fortier, 17 Ib. 121; Morris *v.* White, 28 Ib. 855

[6] Butler *v.* Slocomb, 33 La. Ann. 170; Bouligny *v.* Fortier, supra.

[7] Bowman *v.* McElroy, 14 La. Ann. 587; Doll *v.* Rosetti, 20 Ib. 264.

ment is made without the consent of the mortgagor, such indorsee stands only in the place of the original creditor, and is subject in all respects to the like equities and settlement of accounts as the mortgagee would be, the mortgagor not being bound by the amount appearing on the face of the mortgage.[1]

In Vermont, a suit to foreclose a mortgage was brought by an indorsee for value, before maturity, of the negotiable notes secured thereby, without notice of equities. A defense was introduced that a part of the consideration of the notes was illegal. The indorsee, by his purchase of the notes and mortgage, having acquired all the rights, legal and equitable, of the mortgagee was allowed to maintain an action to foreclose the security for so much of the debt as was legally and fairly contracted.[2] The rights of pledgees of notes properly indorsed and secured by mortgages have been sustained.[3]

§ 174. THE RESTRICTED RULE NOT APPLIED TO COUPON BONDS OR ACCOMMODATION PAPER.—Important exceptions are made in Illinois to the rule declared in Olds *v.* Cummings.[4] Such rule was not applied in a case involving the rights of persons holding long time coupon bonds issued by a railroad company, and payable to "holder;" the payment of which was secured by a deed of trust in like terms. Such bonds, intended to be thrown upon the market to be circulated as commercial paper, and used also as securities for permanent investment, are not within the reason of the rule.[5] Nor is the rule applied in transactions founded upon accommodation paper. In Miller *v.* Larned[6] the court

[1] Wright *v.* Eaves, 10 Rich. Eq. 585.

[2] Shaw *v.* Carpenter, 54 Vt. 155.

[3] George *v.* Woodward, 40 Vt. 672.

[4] 31 Ill. 188.

[5] P. & S. R. R. Co. *v.* Thompso, 103 Ill. 205, overruling C. D. & V. Ry Co. *v.* Loewenthal, 93 Ill. 433. The bonds were payable to "the holders," and the deed of trust was declared to be "for the benefit, protection and security of the persons or corporations who shall hold the bonds about to be issued."

[6] Miller *v.* Larned, 103 Ill. 562.

(Scott, J.) discussing this question, say: "The principle underlying the decision in Olds *v.* Cummings, and other analogous cases in this court, is, that the original mortgagor has equities that are older and superior to any possessed by the assignee of the notes secured, and on the doctrine the oldest equity must prevail, the mortgagor has been let in to make the same defense to the mortgage in the hands of an equitable assignee as he could against the assignor. But what application can this doctrine have to an assignee or holder of accommodation paper? It would be most unreasonable to affirm the grantor in a mortgage to secure accommodation paper, has any equities superior to those of the assignee of the note, who thereby becomes the equitable assignee of the mortgage. Any application of the doctrine of Olds *v.* Cummings to the maker of a mortgage to secure accommodation paper, would be to make a most equitable and reasonable doctrine the means of enabling a party to perpetrate a great wrong on another. A court of equity will not lend its aid for any such purpose."

CHAPTER XVII.

NOTES AND MORTGAGES AS COLLATERAL SECURITY.

§175. The title of the pledgee of notes and mortgages.
176. The pledgee, when subject to equities.
177. The rights of the pledgee in cases of misappropriation.
178. The pledgee, when chargeable with notice.
179. The pledgor's re-transfer of notes and mortgages.
180. The pledge of notes and mortgages to National Banks.
181. The recovery of pledgees and sub-pledgees of notes and mortgages.
182. The pledgee's sale and collection of notes and mortgages.
183. The pledgee's foreclosure and sale of mortgaged lands.

§ 175. The Title of the Pledgee of Notes and Mortgages.—The use by the holder of negotiable promissory notes of a third person, properly indorsed, together with an assignment of the mortgage given to secure the payment of the same, as collateral security for his own principal obligation, vests in the pledgee the legal title to the collateral securities, and enables him, upon default, to render the same available for the purpose of securing payment of his own advances. By such transactions the pledgee gains an additional security as compared with the indorsement and delivery of ordinary negotiable promissory notes as collateral security. The note secured by mortgage has all the characteristics and privileges of commercial paper; and the pledgee thereof receives the further collateral security of the property covered by the mortgage given to secure its payment.[1] As to the negotiable note, the pledgee occupies the

[1] Swift *v.* Smith, 102 U. S. 442; National Bank *v.* Matthews, 98 Ib. 621; Sawyer *v.* Prickett, 19 Wall. 147; Wright *v.* Ross, 36 Cal. 414; Worcester Nat. Bank *v.* Cheeney, 87 Ill. 602; Lowenthal *v.* McCormick, 101

position of a holder for value, in the usual course of business.[1] Nor is it material that the note is indorsed "without recourse," by the pledgor.[2] The assignment of the mortgage, conveying the legal title to such collateral security, is itself an equitable mortgage under which the pledgee is vested with title, as in no other way can the security be made available to him.[3] Such absolute legal transfer may, however, be shown to have been intended as collateral security only.[4] In Louisiana, the title of notes secured by mortgage passes by indorsement for the purpose of collection only.[5]

§ 176. THE PLEDGEE, WHEN SUBJECT TO EQUITIES.— Where such negotiable promissory notes, secured by mort-

Ib. 143; Miller *v.* Larned, 103 Ib. 562; International Bank *v.* Jenkins, 104 Ib. 143; Zimpleman *v.* Veeder, 98 Ib. 613; Tooker *v.* Newman, 75 Ill. 215; Lewis *v.* Kirk, 28 Kan. 497; Clasey *v.* Sigg, 51 Ia. 572; Preston *v.* Case, 42 Ib. 549; McCrum *v.* Corby, 11 Kan. 464; Rice *v.* Dillingham, 73 Me. 59; Brown *v.* Tyler, 8 Gray, 135; Fletcher *v.* Dickinson, 7 Allen, 23; Montague *v.* Boston etc. Ry Co., 124 Mass. 242; Briggs *v.* Rice, 130 Ib. 50; Morris *v.* Bacon, 123 Mass. 58; Blunt *v.* Norris, Ib. 55; Foley *v.* Rose, Ib. 557; Strong *v.* Jackson, Ib. 60; Stevens *v.* Dedham Inst., 129 Ib 547; Smith *v.* Burgess, 133 Ib. 511; Mc Bracken *v.* German Ins. Co., 43 Md. 471; Potts *v.* Blackwell, 4 Jones (N. C. Eq.) 58; Richardson *v.* Mann, 30 La. Ann. 1060; Morris *v.* White, 28 Ib. 855; Logan *v.* Smith, 62 Mo. 455; Bell *v.* Simpson, 75 Mo. 485; Gibson *v.* Martin, 1 Nev. 256; Whiting *v.* Paul, 13 R. I. 40; Walker *v.* Lee, 14 S. C. 142; George *v.* Woodward, 40 Vt. 672; Wells *v.* Wells, 53 Ib. 1.

[1] Michigan Bank *v.* Eldred, 9 Wall. 544, 553; Chicopee Bank *v.* Chapin, 8 Met. 40; Stoddard *v.* Kimball, 6 Cush. 469; Blanchard *v.* Stevens, 3 Ib. 162; Palmer *v.* Yates, 3 Sandf. Ch. 137; Morris *v.* Bacon, 123 Mass. 58; Atkinson *v.* Brooks, 26 Vt. 569.

[2] Blunt *v.* Norris, 123 Mass. 55.

[3] Rice *v.* Dillingham, 73 Me. 59; Slee *v.* Manhattan Co., 1 Paige, 48; Pond *v.* Eddy, 113 Mass. 149; Cutts *v.* York Manuf. Co., 18 Me. 191; Henry *v.* Davis, 7 Johns. Ch. 40; Clark *v.* Henry, 2 Cow. 324; Carr *v.* Carr, 52 N. Y. 251; Clapp *v.* Shepard, 2 Met. 127; Fulton *v.* Fulton, 48 Barb. 581; Wright *v.* Ross, 36 Cal. 414.

[4] Pond *v.* Eddy, 113 Mass. 149; Rice *v.* Dillingham, and Henry *v.* Davis, supra; McIntire *v.* Yates, 104 Ill. 491.

[5] Richardson *v.* Mann, 20 La. Ann. 1060; Commercial Bank *v.* Martin, 1 Ib. 344.

gage, are received unindorsed (indorsement being necessary to convey the title), so that the pledgee is not a party to the instrument, an action against the parties thereto must be brought in the name of the assignor. The pledgee therefore holds both the notes and mortgage subject to equities arising from the fraudulent conduct of the pledgor. Having only an equitable title thereto, he is subject to equities.[1] One of several notes secured by mortgage was entrusted by the owner to a third person to collect, and indorsed so as to pass the title for this purpose. The note was fraudulently transferred after maturity for a valuable consideration, to another person. The holder of the note so receiving it, from one not an owner, and after maturity, took it encumbered with all antecedent equities.[2] A promissory note, having several years to run, showed upon its face that it was secured by mortgage, semble, such note is not an instrument entitled to the privileges of commercial paper. A pledge of such a note under circumstances clearly calculated to excite suspicion, the pledge being in fact an act of gross fraud on the part of the person entrusted with the securities, is not supported.[3] The title of a pledgee of a negotiable promissory note and mortgage security is supported, although the note and mortgage be given for an illegal consideration, rendering them void as between the parties, where such note is indorsed before maturity, for value, and without notice of such invalidity.[4] Where the holder, however, although advancing value, is chargeable with notice of the invalid character of the consideration for such securities, no right or title thereto can be acquired.[5]

[1] McCrum *v.* Corby, 11 Kan. 464; Blunt *v.* Norris, 123 Mass. 55; Smith *v.* Burgess, 133 Mass. 511.

[2] Foley *v.* Smith, 6 Wall. 493.

[3] Strong *v.* Jackson, 123 Mass. 60.

[4] Taylor *v.* Page, 6 Allen, 86. The recovery was restricted to the amount of the valid debt secured by the mortgage in Shaw *v.* Carpenter, 54 Vt. 155.

[5] Pierce *v.* Kibbee, 51 Vt. 559; Butler *v.* Slocum, 33 La. Ann. 170. A note, secured by mortgage, was pledged as collateral security for other notes, which were usurious. The pledgee was allowed to en-

§ 177. The rights of the Pledgee, in cases of misappropriation.—Where the owner of negotiable promissory notes, secured by mortgage or deed of trust, has placed the same in possession of another, so that the latter has, by indorsement where required and assignment, the legal title and apparent absolute ownership of such securities, an innocent pledgee, receiving such notes before maturity, and an assignment of the mortgage, express or implied, upon a valuable advance, made on the faith and credit of such apparent title and ownership, without notice of equities, is protected, although such use of the securities be a misappropriation thereof and a fraud upon the real owner.[1] The like rule is applied for the benefit of an innocent pledgee, who has advanced value, in the usual course of business, upon a negotiable note, secured by mortgage, where the act of misappropriation is made by an agent, who has been entrusted with such note indorsed in blank, and enabled to appear as the apparent owner thereof. Such pledgee is entitled to enforce the mortgage given to secure such note to the full amount, notwithstanding the fraud of the agent.[2] An indorsement "without recourse,"

force the mortgage security, and to apply the proceeds in discharge of the mortgage debt, but not in payment of the notes tainted with usury. Tooke *v.* Newman, 75 Ill. 215.

[1] Morris *v.* Beacon, 123 Mass. 58. A made a note to the order of B, and secured by mortgage, duly recorded. B indorsed the note to C, as collateral security for a loan to a larger amount, stating that the note carried the mortgage with it. Subsequently B fraudulently substituted another note for the one secured by the mortgage, and indorsed it and the mortgage to D for value. Both pledgees acted in good faith. No right of the first pledgee was lost by the fraudulent substitution. Even by agreement the mortgage could not be made a security for a note which it was not intended to secure. The utmost risk the pledgee took was that B might discharge the mortgage, but the note would still remain a valid security; or B might pass the legal title to another, who in law would become the trustee of the pledgee of the note.

[2] Swift *v.* Smith, 102 U. S. 442. The rights of the holder of negotiable promissory notes, secured by trust deed, indorsed in blank by the owner, and handed to an agent for a certain purpose, were sustained, although the agent misappropriated the same by pledging them as collateral security for his own note,

before maturity, by a pledgor of a note made by a third person, and secured by mortgage, although such note was obtained from the maker by artifice, vests the title to the note and the mortgage security in a pledgee for value, in good faith, and without notice by the record of any previous assignment of the mortgage or other equity. The title of the pledgee, under such circumstances, is that of a purchaser for a valuable consideration, and is preferred as against the owner, and a prior pledgee who had received unindorsed the note originally issued with the mortgage, but with no assignment of the mortgage, or record thereof, although upon a bona fide advance.[1] The lien of a pledgee, holding the legal title to the note and mortgage, is not defeated as against third persons chargeable with notice, by the fraud or mistake of the mortgagee in entering satisfaction of the mortgage upon the record.[2]

§ 178. The Pledgee, when chargeable with notice.—The pledgee of negotiable paper, secured by a mortgage or deed of trust, is chargeable with notice of misappropriation, or want of authority, under the same presumptions governing in other cases of pledge of ordinary commercial instruments. Where such securities show upon their face the existence of a trust, pledgees are bound to take notice thereof, and to make inquiry, at their peril.[3] A, as trustee, held a note made to himself personally, and a mortgage securing the payment of the same, the mortgage stating that the consideration was paid by A "as trustee for" B, and referred to A as "trustee as afore-

given for a loan of money. Default occurring upon the personal note of the pledgor, the pledgee, as a purchaser for value, without notice, was allowed to enforce the trust deed.

[1] Blunt *v.* Norris, 123 Mass. 55.

[2] Gibson *v.* Martin, 1 Nev. 256.

[3] Sturtevant *v.* Jaques, 14 Allen, 523; Shaw *v.* Spencer, 100 Mass. 382; Fisher *v.* Brown, 104 Ib. 261; Monitor Ins. Co. *v.* Buffum, 115 Ib. 345; Duncan *v.* Jaudon, 15 Wall. 175. General obscurity in a writing will not entitle anybody to buy it without taking pains to ascertain what the hieroglyphics mean. Smith *v.* Burgess, 133 Mass. 511.

said." After recording the mortgage, A struck out the words "as trustee," and then borrowed money for his own use of C, transferring the note and mortgage as collateral security. The advance was made in good faith, but the pledgee failed to read the mortgage, and made no examination of the record. C being chargeable with notice of the contents thereof, the pledgee was not regarded as a bona fide holder for value of the securities, and was ordered to return them to the successor in trust. The Supreme Judicial Court of Massachusetts (Allen, J.)[1] say: "The note and mortgage had reference to one transaction, and if L held one of them as trustee, there was reason to suppose he did the other also. The mortgage was a constituent part of the security. It was not only a link in the title which he was taking, but it was itself produced and delivered to him as representing the title. The truth appears to be that the defendant (the pledgee) accepted the mortgage without taking pains to read it. If he had read it he would have discovered all that was necessary for his protection. The law holds him to the legal duty of reading it, and of informing himself of all it contained. He must be conclusively presumed to have performed this duty, and can not be heard to say that he did not. His legal position is the same as if he had actually read it." Nor did the omission of the word "trustee" from the note excuse the pledgee from examining the title to the mortgage security.

§ 179. The Pledgor's re-transfer of notes and mortgages.—The pledgor of negotiable notes, secured by mortgage, may, with the consent of the pledgee, re-transfer such collateral securities to another pledgee, or for a new loan, and the title thereto thus obtained will be enforced. Certain notes of a third person, payable at different times, and secured by a mortgage, were held as collateral security for indebtedness. The pledgor may, with the consent of

[1] Smith *v.* Burgess, 133 Mass. 511.

the pledgee, transfer to another of his creditors a portion of the notes to hold as collateral security, and may agree that the mortgage securing the payment of the notes shall stand as a prior security for the notes so re-assigned, at the same time giving to the first pledgee new securities of equal value. A contest arose as between the two pledgees upon the question of priority in the distribution of the proceeds upon foreclosure and sale under the mortgage; the pledgor's agreement in favor of the second creditor was supported, he having remained the general owner of the securities, and having furnished other collateral securities to the first pledgee.[1] A bank loaned money on negotiable notes, secured by deed of trust. The loan was paid, but the bank retaining the securities, a further specific pledge thereof was made as collateral security for another loan. The rights of the pledgee under the second loan were supported as against a bona fide purchaser for value of the property covered by the mortgage from the real owner thereof, who had obtained a deed of the equity of redemption of the apparent purchaser from the person in whom the title stood of record, and who gave the notes and trust deed for the purchase price, such notes and mortgage having been transferred for value to a pledgee without notice.[2]

§ 180. THE PLEDGE OF NOTES AND MORTGAGES TO NATIONAL BANKS.—A national bank, holding a negotiable promissory note secured by mortgage or deed of trust, as collateral security for the payment of loans is entitled, upon default, to the enforcement of the mortgage security, although it be insisted as a defense, that the taking of such real estate security by a national bank is an act under sections 5136 and 5137 of the United States Revised Statutes, *ultra vires* the bank.[3] In the leading case upon this subject,[4]

[1] George *v.* Woodward, 40 Vt. 672.

[2] Miller *v.* Larned, 103 Ill. 562.

[3] Swope *v.* Leffingwell, 105 U. S. 3; National Bank *v.* Whitney, 103 Ib. 99; National Bank *v.* Matthews, 98 Ib. 321.

[4] National Bank *v.* Matthews, 98 U. S. 621. As the deed of trust was

a negotiable promissory note, secured by a deed of trust, with the usual powers of sale upon default, was indorsed with the mortgage security, to a national bank as collateral security for a loan. Upon default, the bank requested the trustee to sell the property. A bill in equity was filed in a circuit court in the State of Missouri to enjoin the sale, and an injunction was granted and sustained against such sale. But upon a writ of error issued from the United States Supreme Court, the right of the pledgee to enforce the collection of the collateral note by a sale of the lands covered by the trust deed, was fully supported. Courts of equity have always refused, under like circumstances, to use the discretionary powers vested in their chancellors to relieve borrowers from national and other banks or corporations from the re-payment of bona fide loans, upon a defense of *ultra vires* as against the lender. The equity of the lender of money in good faith, is preferred to that of persons and corporations who have had the benefit thereof and still retain the same, or the property acquired therewith, and yet seek to avoid repayment upon a legal technicality, which was never intended to shelter fraud.[1] The rule is applied, in the

not made to the bank, the United States Supreme Court held that it did not come within the letter of the statute in any event, and that, if it had done so, the court would not have afforded the relief sought. "A court of equity," say the court, "is always reluctant in the last degree to make a decree which will effect a forfeiture. The bank parted with its money in good faith. Its garments are unspotted under these circumstances. The defense of *ultra vires*, if it can be made, does not address itself favorably to the mind of the chancellor." The Supreme Court of Missouri followed the rule in later cases. Thornton *v.* National Exch. Bank, 71 Mo. 221; Swope *v.* Leffingwell, 72 Ib. 348; affirmed, 105 U. S. 3.

[1] Orm *v.* National Bank, 16 Kan. 341; Macon R. R. Co. *v.* Georgia R. R. Co., 63 Ga. 103; First Nat. Bank *v.* Hair, 36 Iowa, 443; Argenti *v.* San Francisco Co., 16 Cal. 255; Empire Ins. Co. *v.* Stewart, 46 Mich. 482; Warner *v.* DeWitt Nat. Bank, 4 Bradw. 312; Bradley *v.* Ballard, 55 Ill. 413; Nuerbach *v.* LeSueur Mill Co., 28 Minn. 291; Thornton *v.* National Exch. Bank, 71 Mo. 221; Swope *v.* Leffingwell, 72 Ib. 348; Pancoast *v.* Trav. Ins. Co., 79 Ind. 172; Lebanon Bank *v.* Hallenbeck, 29 Minn. 322; Hall *v.* Mutual Ins. Co., 32 N. H. 297; Mc Clure *v.* Railroad Co., 13 Gray, 124;

absence of restrictive statutory enactments, in favor of banking and loaning corporations, advancing money bona fide in states or countries other than those in which they are organized as corporate bodies.[1]

§ 181. The Recovery by Pledgees and Sub-pledgees of Notes and Mortgages.—The pledgee for value advanced in good faith, without notice, holding negotiable promissory notes, secured by mortgage, before maturity, as collateral security, is entitled to enforce the mortgage security in a court of equity, and to recover the full face of the notes secured, holding any surplus above the amount of the loan or debt for the benefit of those beneficially entitled thereto.[2] The like rule is enforced in favor of a sub-pledgee of notes and mortgages, receiving the same, with the evidence of the principal debt, for which they were pledged, upon an advance in good faith to the pledgee thereof, and without notice of equities. As against a subsequent purchaser for value of the property chargeable with notice, the sub-pledgee is allowed to collect the full amount of the note secured by the mortgage.[3] In states where the restricted rule prevails, subjecting indorsees of

Mott *v.* United States Trust Co., 19 Barb. 568; Silver Lake Bank *v.* North, 4 Johns. Ch. 470; Carey *v.* Railroad Co., 29 Barb. 35; Bissell *v.* Railroad Co., 22 N. Y. 258; Baird *v.* Bank of Washington, 11 S. & R. 411; Woods *v.* National Bank, 83 Pa. St. 57; Winton *v.* Little, 94 Ib. 64; Stone *v.* Brown, 54 Tex. 330; Howard Nat. Bank *v.* Loomis, 51 Vt. 349; Central Trust Co. *v.* National Bank, 11 Biss. (15 C. L. N. 268); Zabriskie *v.* Railroad Co., 23 How. 381; Railroad Co. *v.* Howard, 7 Wall. 413; Fleckner *v.* Bank of U. S., 8 How. 338, 353; National Bank *v.* Whitney, 103 U. S. 99; Swope *v.* Leffingwell, 105 Ib. 3; Blackburn Building Society *v.* Cunliff, L. R. 22 Ch. D. 61; in re Cork & Y. Ry. L.R. 4 Ch. 748.

[1] Christian Union *v.* Yount, 101 U. S. 356; Cowell *v.* Springs Co, 100 Ib. 55; Farmers Loan etc. Co. *v.* McKinney, 6 McLean, 7; Natona Water Power Co. *v.* Clarkin, 14 Cal. 582; Stevens *v.* Pratt, 101 Ill. 206, 214; Commercial Ins Co. *v.* Scammon, 102 Ib. 46.

[2] McCrum *v.* Corby, 11 Kan. 464; Gibson *v.* Martin, 1 Nev. 526; Hurst *v.* Coley, 15 Fed. Rep. 645.

[3] Miller *v.* Larned, 103 Ill. 562.

negotiable paper, seeking to enforce payment by foreclosure and sale of the property in equity, to defenses not available against the note, a sub-pledgee who advances money to take up securities held in pledge for a loan is restricted in his recovery, as against the mortgagor and maker, his representatives, and bona fide purchasers for value, to the amount of the actual advance by the pledgee upon receiving such note and mortgage as collateral.[1]

Where a negotiable note and mortgage are sub-pledged before maturity by a pledgee, with full title, for a greater sum than the amount of the original loan to the pledgor, a sub-pledgee advancing a valuable consideration thereon, in good faith, and without notice of equities, is a purchaser for value of such note and mortgage, to the extent of his advances, and may enforce the same for the face thereof, holding any surplus for the persons entitled thereto. The pledgor having, by reason of his misplaced confidence in entrusting the legal title and apparent absolute ownership of such negotiable securities and mortgage to a third person, enabled him to deceive an innocent sub-pledgee advancing money on the credit of such title and ownership, is estopped to set up any defenses existing between himself and the pledgee as against such sub-pledgee, and is only entitled to recover his securities upon payment of the full amount advanced.[2]

Upon sub-pledges of mortgage securities made for less than the amount of the original advances, where the whole interest of the pledgee is assigned for the greater security of the sub-pledgee, and the persons bound upon the securities become insolvent, the sub-pledgees are allowed to prove for the whole amount secured by the first pledge, although not receiving more than what is due them for the principal, interest, and costs.[3] The rule as to recovery of the sub-pledgee applies where the amount advanced by the sub-pledgee is

[1] Loewenthal *v.* McCormick, 101 Ill. 143.

[2] Briggs *v.* Rice, 130 Mass. 50.

[3] In re Burrell, L. R. 7 Eq. 379.

less than the sum loaned the pledgor thereon by the pledgee. The actual recovery is limited to the amount of the advances, where the owner of the securities seeks to redeem the same.[1]

§ 182. THE PLEDGEE'S SALE AND COLLECTION OF NOTES AND MORTGAGES.—Powers of sale given in contracts of pledge of negotiable promissory notes and mortgages, without advertisement or notice to the pledgor, and at public or private vendue, while valid, if carried out in good faith, are yet closely scrutinized, and should any element of fraud enter into them, no rights can be acquired thereby. Such negotiable instruments, although secured by mortgage, come within the general rules governing the realization of negotiable collateral securities. The pledgee thereof is not permitted to sell them at either public or private sale, except with the consent of the pledgor, either given by contract of pledge, or agreed to subsequently. A sale by a pledgee of a note and mortgage to the mortgagor, made on a pre-arranged plan, under a power of sale, public or private, without advertisement or notice to the pledgor, for the exact amount of the loan thereon, being about one-half its face value, is not a payment of the note. The pledgor may have his suit in equity to foreclose and sell the land, the maker and mortgagor being credited with the actual amount paid at the sale as a payment on the note, and this although the note is produced marked "paid" at the hearing.[2] The purchase by a pledgee of notes and mortgages of lands at a foreclosure sale at less than the face of the notes and immediately thereafter reselling them for a sum greater than the notes, renders the pledgee liable, not for the excess, but for a sum sufficient to pay the collateral notes.[3] Where a pledgee of notes and mortgages has returned the same to the pledgor for the purpose of making

[1] Draper *v.* Saxton, 118 Mass. 427.
[2] Zimpleman *v.* Veeder, 98 Ill. 613.
[3] Richardson *v.* Mann, 30 La. Ann. 1060.

collection thereof for account of the pledgee, the latter may bring trover (or a statutory substitute therefor) against the pledgor, upon his failure, after demand, to return or account for the collaterals. The measure of damages in such a case, is the interest of the pledgee in the collaterals, being the amount of the debt where they are of greater value, or their full value, where less.[1]

§ 183. THE PLEDGEE'S FORECLOSURE AND SALE OF THE MORTGAGED LAND.—The holder of a negotiable promissory note, secured by mortgage, as collateral security for a debt, is entitled, upon default, to proceed with the foreclosure of the property included in the mortgage security, and to entry, and possession thereof, under appropriate proceedings.[2] Such proceedings, however, do not change the relations of the parties to the contract of pledge, the land being simply substituted as collateral security in place of the notes and mortgage, and remaining subject to redemption.[3] Nor, as between the pledgor and pledgee, is such foreclosure, entry and possession a payment of the debt for which the notes and mortgages are held as collateral security.[4]

[1] Hurst *v.* Coley, 15 Fed. Rep. 645.

[2] Brown *v.* Tyler, 8 Gray, 135.

[3] Brown *v.* Tyler, supra; Montague *v.* Boston R. R. Co, 124 Mass. 242; Henry *v.* Davis, 7 Johns. Ch. 40; Slee *v.* Manhattan Co., 1 Paige, 52, 79; Clapp *v.* Sheppard, 2 Met. 127; Rice *v.* Dillingham, 73 Me. 59; Hoyt *v.* Martense, 16 N. Y. 231; Dalton *v.* Smith, 86 N. Y. 176.

[4] Stevens *v.* Dedham Savings Inst. 129 Mass. 547. A note for $7,320, executed by H. dated in 1845, payable in five years, secured by mortgage, was indorsed and the mortgage assigned to the bank as collateral security for a note of $3,500, payable in one year. Upon default in both the principal note and in the conditions of the mortgage, in 1847, the pledgee commenced an action upon the mortgage, obtaining a conditional judgment for the amount of the principal debt It then took possession of the land under execution, which was retained until 1852, when the land was conveyed for $5,500, and several successive conveyances were made. The pledgor had never settled with the pledgee, nor received his own note, nor the collateral mortgage note. A bill in equity to redeem was brought in 1870, but dismissed because of laches.

After such foreclosure, entry, and possession, the pledgee is under no obligation to take the land as in payment of his debt. He should proceed with convenient speed to reduce such property to cash, by a fair and proper public sale.[1] In this, he acts as trustee for the pledgor, and is required to pay over to him any balance remaining after the payment of the debt for which the notes and mortgage were held as security; or, if the debt and other proper charges, be paid, to release and quitclaim the land to the pledgor.[2] As against the mortgagor, the pledgee will have an absolute title, but not as against the pledgor; although where possession of the land for over twenty years has been held by the pledgee or his successive assignees, a claim to redeem by the pledgor is not favored in equity.[3] It is only from the time of the realization in money, after foreclosure of the mortgage securities held in pledge, that the statute of limitations begins to run against the pledgor, where, the debt being paid, a surplus remains in the hands of the pledgee.[4]

[1] Brown *v.* Tyler, supra.

[2] Stevens *v.* Dedham, supra; Dalton *v.* Smith 86 N. Y. 176; Montague *v.* Boston R. R. Co., 124 Mass. 242.

[3] Ib.; Ayres *v.* Waite, 10 Cush. 72.

[4] Brown *v.* Tyler, 8 Gray, 135.

CHAPTER XVIII.

THE ASSIGNMENT OF BONDS AND MORTGAGES.

§184. The assignee's title to the mortgage security.
185. The equities to which the assignee is subject—the New York rule.
186. The rule in New Jersey, Pennsylvania and Virginia.
187. The assignment of bonds and mortgages under estoppel.
188. Limitations of the application of estoppel in pais.
189. Estoppel in pais, by mortgagor's certificate of "no defense."
190. The bond and mortgage, under indorsement, quasi-negotiable.
191. Assignment of void, invalid, and fraudulent securities.
192. Payments to mortgagee, after assignment.
193. Release by mortgagee, after assignment.

§ 184. The Assignee's Title to the Mortgage Security. — In three or four states, notably New York, Pennsylvania and New Jersey, where loans are sought upon the security of real estate as well as upon the individual liability of the borrower, the personal evidences of indebtedness, for which the mortgage is given as collateral security, are bonds, non-negotiable in character. Such obligations are subject to onerous equities in the hands of any assignee, however remote. The equities include those existing between the original parties, and attending the original transaction, and the equitable rights of third persons, cestuis que trust, and others. The bona fide assignee for value of such collaterals is limited in his recovery thereon to the actual amount validly due as between the original parties, subject to set-offs, and the equities stated; and the mortgage, as an incident to the debt, and equally non-negotiable, and subject to the like equities, cannot be enforced by such assignee for any larger sum. Such limited recovery upon

enforcing the mortgage security, when given with a non-negotiable bond, is consonant with the approved rule under which the indorsee for value, before due, in good faith, of negotiable promissory notes, secured by mortgage, recovers the face value of the notes, free from antecedent equities, when enforcing the mortgage incident. Under this view, bonds and mortgages constituting a poor security for the loan of money, the use has become general of indorsement of certificates by mortgagors and obligors that they have no defenses, equities, or set offs. Where such certificates are indorsed or attached, the assignee of a bond and mortgage, without notice of equities, and for value advanced on the faith and credit of the representations so made, may invoke the rules of estoppel in pais, or equitable estoppel, as against the mortgagor and obligor, notwithstanding the original transaction, as between the parties, was without consideration, or a gross fraud. Under the rules stated, a sub-assignee, with knowledge, may take a valid title from a bona fide assignee for value, without notice of equities. The representations contained in such certificates are of as binding effect as if made upon the favored instruments of commerce, and pass upon assignment to successive holders for value, as where negotiable paper is indorsed in blank. Bonds and mortgages, thus freed from antecedent equities, become available collateral securities.[1]

§185. THE EQUITIES TO WHICH THE ASSIGNEE IS SUBJECT—THE NEW YORK RULE.—In an early case, in New York,[2] Chancellor Kent, considering the equities to which

[1] Kamena *v.* Huelbig, 23 N. J. Eq. 78; Woodruff *v.* Morristown Inst., 34 Ib. 174; Shafer *v.* Reilly, 50 N. Y. 61; Andrews *v.* Etna Life Ins. Co., 85 Ib. 334; Wegh *v.* Boylan, Ib. 394; Riggs *v.* Pursell, 87 Ib. 608; Mc Murtrie *v.* Twitchell, 11 Phila. 357; Holtz *v.* Belden, 12 Ib. 498; Ashton's App. 73 Pa. St. 153; Penn. R. R. Co's App. 86 Ib. 80; Robert *v.* Hay, 91 Ib. 242; Mifflin County Bank's App. 98 Ib. 150; Etheridge *v.* Parker, 76 Va. 247 (14 Rep. 186); Howell *v.* Hall, 5 Lea, 405.

[2] Beebe *v.* Bank of New York, 1 Johns. 552, where the majority of

the assignee of a non-negotiable bond, seeking to enforce the mortgage security, was subject, restricted the same to those existing as between the mortgagor and mortgagee only. A similar opinion was stated by Justice Sutherland, in a later case[1] and in Corning *v.* Murray.[2] Even in these early cases, a majority of the court held the more extended view, and the question was finally settled in Bush *v.* Lathrop,[3] where the rule was established that the assignee of a bond and mortgage takes only such title as his assignor had and no other, and is subject as well to all the equities of third persons as to those of the original mortgagor and mortgagee. In that case the pledgee of a bond and mortgage, holding the same under an assignment of the absolute title thereto as collateral security for a smaller sum than the face of the bond, made a sub-pledge thereof to a third person who advanced its full value in good faith, without notice. The fact that an assignee has no notice of such equities at the time he makes his advance, is immaterial.[4] The rule announced was modified in later cases,[5] but in the leading case of the Trustees of Union College *v.* Wheeler[6] the Court of Appeals of New York declared that Bush *v.* Lathrop, supra, had been overruled only as to the point that an assignor of a chose in action is estopped to set up any equities affecting the title between himself and his assignee is an action brought by a second assignee, and not as qualifying the rule as to the rights of an assignee in enforcing the mortgage, or as to equities growing out of the chose in action itself. The rule is declared well settled that the assignee of a bond and mortgage takes the security subject to equities attending the original transaction, that

the court overruled the learned chancellor. Clute *v.* Robinson, 2 Ib. 612; Livingston *v.* Dean, 2 Johns. Ch. 479.

[1] James *v.* Morey, 2 Cow. 298.

[2] 3 Barb. 652.

[3] 22 N. Y. 535.

[4] Bank for Savings *v.* Frank, 45 N. Y. Supr. Ct. 404.

[5] Dillaye *v.* Commercial Bank, 51 N. Y. 345; Moore *v.* Metropolitan Bank, 55 Ib. 41.

[6] 61 N. Y. 88.

he takes no greater rights than his assignor, and that the true test is, to inquire, what can the mortgagee do by way of enforcement of it as against the property mortgaged. What he can do, the assignee can do, and no more. The rule that the assignee of a bond and mortgage takes the security, subject to equities attending the original transaction in favor of the mortgagor and of prior equitable claims of third persons, is followed in several decisions, and is the rule in New York state.[1]

§ 186. THE RULE IN NEW JERSEY, PENNSYLVANIA AND VIRGINIA.—The established rule in New Jersey is that the assignee of a mortgage given to secure a bond (and it would seem[2] a promissory note) receives it subject to all defenses which the mortgagor may have against it, but free from any secret equities existing in favor of third persons, cestuis que trust, and others, of which the assignee has no notice.[3] In cases where such assignee has notice of equities of third persons, he is subject thereto.[4] The assignee takes the security subject to all the equities of the mortgagor, whether open or secret;[5] and to protect himself from loss, such assignee should learn from the mortgagor, before taking an assignment of the bond and mortgage, whether there be any defenses, set-offs or objections thereto.[6] A sub-assignee from an assignee, with constructive notice

[1] Ingraham *v.* Disborough, 47 N. Y. 421; Schaefer *v.* Reilly, 50 Ib. 61; Greene *v.* Warwick, 64 Ib. 220; Crane *v.* Turner, 67 Ib. 437; Bank for Savings *v.* Frank, 45 N. Y. Supr. Ct. 404; Viele *v.* Judson, 82 Ib. 381; Davis *v.* Leopold, 87 N. Y. 620.

[2] Woodruff *v.* Morristown Inst. 34 N. J. Eq. 174.

[3] Shannon *v.* Marselis, 1 N. J. Eq. 413; Losey *v.* Simpson, 11 Ib. 254; Woodruff *v.* Depue, 14 Ib. 175; Atwater *v.* Underhill, 22 Ib. 17, 599; Kamena *v.* Huelbig, 23 Ib. 78; Mc Farland *v.* Gilchrist, 25 Ib. 487; Starr *v.* Hasbrouck, 26 Ib. 414; Bush *v.* Cushman, 27 Ib. 131; Putnam *v.* Clark, 29 Ib. 415; Vredenburgh *v.* Burnett, 31 Ib. 231; s. c. 34 Ib. 252; Woodruff *v.* Morristown Inst. 34 Ib. 174.

[4] Losey *v.* Simpson, supra; Danbury *v.* Robinson, 14 N. J. Eq. 213.

[5] Conover *v.* Van Mater, 18 N. J. Eq. 484; Atwater *v.* Underhill, 22 Ib. 606.

[6] Jones *v.* Esler, 18 N. J. Eq. 61; Losey *v.* Simpson, supra.

of prior equities, stands in no better position than his assignee.[1]

In Pennsylvania, an assignee for value of a non-negotiable bond and mortgage is subject to all equities, open and secret, of the mortgagor, but not subject to equities of third persons of which he had no notice, express or implied;[2] or subject to the same equities and rules that govern other non-negotiable instruments or claims.[3] The assignee is not subject to equities existing between the mortgagor and a prior assignee of the same mortgage.[4] The obligor and mortgagor, who has not estopped himself by affirmative acts or representations or neglects, upon the faith of which an assignee has advanced his money, is entitled to insist, as against any assignee of the securities, upon any defense or equity which could have been insisted upon as against the obligee and mortgagee.[5]

In Virginia, it was held in an early case,[6] that an assignee of a non-negotiable chose in action, like a bond secured by mortgage, receives it subject to all the equities of the debtor against the assignor existing at the date of the assignment, or which arise after the date of the assignment, and before the debtor has notice of it, and this notwithstanding the assignment be for value received, and without notice of equities. The rule applies only where the debtor has an equity for relief, or a ground of defense based on honest transactions between himself and his assignor, and is not intended as a cover for fraud. It was not applied in a case where a married woman, with power to

[1] Rose *v.* Kimball, 16 N. J. Eq. 185.

[2] Davis *v.* Barr, 9 S. & R. 140; Mott *v.* Clark, 9 Pa. St. 399; Taylor *v.* Gitt, 10 Ib. 428; Prior *v.* Wood, 31 Ib. 399; Michener *v.* Cavender, 38 Ib. 337; McConnell *v.* Wenrich, 16 Ib. 365; Twitchell *v.* McMurtrie, 77 Ib. 383; Mifflin County Nat. Bank's App., 98 Ib. 150; Blair *v.* Mathiott, 46 Ib. 262; Wetherell's App., 3 Grant, 281; McCandless *v.* Engle, 51 Pa. St. 309.

[3] Hortsman *v.* Gerker, 49 Pa. St. 382.

[4] Reineman *v.* Robb, 98 Pa. St. 474; Blair *v.* Mathiott, supra; Downey *v.* Thorp, 63 Ib 322.

[5] Ashton's App. 73 Pa. St. 153; Hutchinson *v.* Gill, 91 Ib. 253.

[6] Norton *v.* Rose, 2 Wash. 233.

convey her real estate, executed a bond secured by a deed of trust, and the securities passed by assignment to a bona fide purchaser for value, without notice of the fraud. The equities of the assignee were preferred as against a third person, who had actively participated in the fraud, and was seeking to defeat his title.[1]

§ 187. The assignment of Bonds and Mortgages under Estoppel.—The rules of equitable estoppel are invoked for the benefit of the assignee for value without notice, of bonds and mortgages, to relieve him from the onerous defenses and equities to which he is usually subject in enforcing his mortgage security, although advancing a valuable consideration, in good faith, and without notice. The rules of estoppel are applied where one person either by words or conduct, induces another to believe that he may safely take a certain security, and he relying upon such representation, acquires such security, the former is never permitted in a court of equity to overthrow the title so acquired.[2] A mortgagor is estopped where by concealing his equities or misleading an assignee, justice would be defeated by allowing him to set up a defense founded on an equity available as against the mortgagee.[3]

The rules of equitable estoppel are also applied where an owner of a bond and mortgage entrusts the same to an agent, so that he has the full legal and equitable title and the apparent absolute ownership thereof, by whom they are assigned, without notice, to an innocent person who advances his money upon the faith and credit of such title and apparent ownership.[4] The rules are also applied in

[1] Etheridge *v.* Parker, 76 Va. 247 (14 Rep. 186).

[2] Morris' Canal etc. Co. *v.* Lewis, 12 N. J. Eq. 332; Brinkerhoff *v.* Brinkerhoff, 23 Ib. 477; Woodruff *v.* Morristown Inst., 34 Ib. 174.

[3] Woodruff *v.* Morristown Inst., 34 N. J. Eq. 174.

[4] Kamena *v.* Huelbig, 23 N. J. Eq. 78.

favor of persons advancing value in good faith, as against cestuis que trust in cases where a trustee holds bonds and mortgages with an apparently absolute power of disposition.[1] It was also enforced in Moore *v.* Metropolitan Bank[2] in which a bona fide purchaser for value of a non-negotiable chose in action from one upon whom the owner had by assignment, conferred the apparent ownership, making such purchase on the faith thereof, obtained a valid title as against the real owner and the world.[3]

§ 188. Equitable Limitations upon the application of Estoppel.—In order that the equitable rules of estoppel in pais may be applied, it is necessary that the mortgagor shall have done an act or made an admission, the natural effect of which is to influence the conduct of the assignee, and which has induced him to change his position or condition, so that if the mortgagor is afterwards permitted to deny the truth of his conduct or his words, the assignee will suffer injury.[3] And where a trustee has made a colorable assignment of bonds and mortgages, for his own benefit, to an assignee for value, chargeable with notice of the misappropriation, no rights, as against the cestuis que trust, can be acquired by such assignee, by reason of his *mal fides*.[4] A person who is seeking to protect himself, as against clear proof of fraud and misappropriation in the original transaction between the mortgagor and mortgagee, by invoking the rules of equitable estoppel is himself bound to the exercise of good faith in his subsequent connection with the collaterals, and must show that his advance of value was made promptly upon his faith and belief in the truth of the representations made and as a proximate result thereof, and

[1] Danbury *v.* Robinson, 14 N. J. Eq. 213; First National Bank *v.* Corry, 22 Hun, 339; Dillaye *v.* Commercial Bank, 51 N. Y. 345.

[2] 55 N. Y. 31.

[3] Mutual Life Ins. Co. *v.* Norris, 31 N. J. Eq. 585; Woodruff *v.* Norristown Inst., 34 Ib. 174.

[4] Dey *v.* Dey, 26 N. J. Eq. 182.

that he will, as an innocent person, be prejudiced if they are allowed to be disputed.[1]

§ 189. Estoppel in pais, by Mortgagor's certificate of "No defense."—The rules of estoppel in pais or equitable estoppel, as applied in favor of assignees for value of bonds and mortgages, are most frequently invoked in cases where the mortgagor and obligor, upon the execution of the bond and mortgage, has indorsed a certificate thereon to the effect that he has "no defenses, equities, or set-offs of any kind" against such mortgage, or that the same is a valid security, and that he has received full payment, or other like terms. In such cases, the assignee who has advanced value on the faith of such certificate, in good faith, without notice, is entitled to enforce the security, although there be fraud or want of consideration as between the mortgagor and mortgagee.[2] Where a mortgagor has signed a certificate that he has "no defense" to such security, the fact that an assignment of such bond and mortgage is an actual misappropriation by an agent entrusted therewith, with full title, is no defense as against an assignee for value, without notice.[3] Even where the money thus obtained has never been accounted for, the mortgage security is not affected by such misappropriation, the purchaser being under no obligation to look to the application of such proceeds, nor responsible for their misappropriation.[4]

Such certificate of "no defense" defeats the equities of third parties arising out of a collateral agreement, the assig-

[1] Andrews *v.* Etna Life Ins. Co., 85 N. Y. 334.

[2] McMurtrie *v.* Twitchell, 11 Phila. 351; Ashton's App. 73 Pa. St. 153; Diercks *v.* Kennedy, 16 N. J. Eq. 210; Bush *v.* Cushman, 27 Ib. 131; Woodruff *v.* Morristown Inst. 34 Ib. 174. See Raley *v.* Williams, 73 Mo. 310.

[3] Robertson *v.* Hay, 91 Pa. St. 242; Hutchinson *v.* Gill, Ib. 253.

[4] Gray's Admr. *v.* Bank of Kentucky, 29 Pa. St. 365; Pa. R R. Co.'s App. 86 Ib, 80; Robertson *v.* Hay, supra; Hutchinson *v.* Gill, supra.

nee having no notice thereof.[1] Nor will a mortgagor be permitted to set up usury in the loan, where he has given such certificate, as against an assignee for value, without notice.[2] Nor will the want of a formal acknowledgment by a wife of a mortgagor securing the payment of a bond, in which her husband joined, affect the application of the rules of equitable estoppel arising from such certificates of "no defense."[3] But, as delivery and assignment of a bond and mortgage for which no value is paid, as between the parties, is essential, a bona fide assignee thereof for value, receiving it at a time subsequent to its execution, is not entitled to priority, in the proceeds of the mortgaged property, as against an intervening lienor, in good faith, who has complied with all statutory requirements as to notice, although the mortgage was executed and recorded prior to the attaching of his lien. Nor is it material, as against the equity of such third person, that at the time of the assignment, the mortgagor made an affidavit falsely reciting that the mortgagee had advanced the whole sum without abatement, and that there were no off-sets, defenses, or counterclaims, and although, as against the mortgagor, an estoppel to show the truth arose.[4]

§ 190. The Bond and Mortgage, under indorsement, Quasi-negotiable.—Under the application of the rules of estoppel in pais or equitable estoppel, arising upon the indorsement of certificates of no defense or equities, and like declarations, or acknowledgments of the receipt of the whole sum named, and by other affirmative acts or neglects of the mortgagor, a bona fide sub-assignee for value without notice, acquires a good title as against the owner, or third persons, or creditors, although such bond and mortgage were fraudulently obtained by his assignor. Upon the

[1] Riggs *v.* Pursell, 87 N. Y. 608.
[2] Wegh *v.* Boylan, 85 N. Y. 394, 401.
[3] Holtz *v.* Belden, 12 Phila. 498; Howell *v.* Hall, 5 Lea, 405.
[4] Schafer *v.* Reilly, 50 N. Y. 61.

same rule of estoppel in pais, a bona fide grantee for value without notice of a prior unrecorded deed, acquires a valid title, although his grantor is chargeable with full notice of fraud.[1] The rules of equitable estoppel are also applied for the benefit of sub-assignees for value of bonds and mortgages, upon which such certificates of payment and of no defense have been indorsed, in cases where they have acquired the same under assignment from a bona fide holder for value, without notice, although chargeable with notice of fraud or breach of trust in the original transaction. Such representations indorsed upon bonds and mortgages partake, under the operation of the rules of estoppel in pais, of the nature of blank indorsements of negotiable instruments. They pass from hand to hand, and any subsequent assignee thereof, although having notice of equities, may claim protection under a bona fide holder for value, without notice, in the line of assignments. Such rules of estoppel in pais are supported upon the ground that where bonds and mortgages are issued indorsed as stated, for the purpose of obtaining money thereon for the use of the mortgagor, it is a presumption therefrom that the intention of the mortgagor was that the securities should be available as collateral or otherwise, and that the market should not be closed upon the first assignee, except upon his consent to indorse a new certificate. If the rule were otherwise, a bona fide assignee for value, without notice, of a bond and mortgage, so indorsed, would lose one of the chief advantages necessarily belonging to that favored position.[2]

§191. Assignment of void, invalid and fraudulent Securities.—Where the mortgage security itself is absolutely void, it is not enforced as security for any purpose of reimbursement or indemnity.[3] Where a conveyance,

[1] Wegh *v.* Boylan, 85 N. Y. 394; Schafer *v.* Reilly, 50 N. Y. 61.

[2] Ashton's App. 73 Pa. St. 153; McConnell *v.* Wenrich, 16 Pa. St. 365; Mott *v.* Clark, 9 Ib. 405.

[3] Boyd *v.* Dunlap, 1 Johns. Ch. 478; Union Nat. Bank *v.* Warner, 12 Hun, 306; Savage *v.* Murphy, 34 N. Y. 508; Shand *v.* Handley, 71 Ib. 319.

made by a husband through a third party to his wife, is fraudulent as to the creditors of the husband, and the wife is a party to the fraud, no protection for any sum paid or liability incurred will be given her.[1] Otherwise, where an assignee for value is without notice of the fraud. In such case, the assignee is protected to the amount of his advances.[2] In cases of fraud, the assignee for value, without notice, is not allowed to enforce the personal obligation of the bond, although his claim under the mortgage security is good as against the land. As assignee of a non-negotiable bond, he stands in the same position as his assignor, and in the absence of fraud, gross negligence, or misconduct on the part of the obligor or maker, is subject to all the equities against such bond in the hands of the original obligee or payee.[3] Nor will a bond and mortgage, while invalid in the hands of the mortgagee, become a valid security in the hands of an assignee for value, chargeable with notice.[4] Nor, when a valid bond and mortgage is assigned to secure the performance of an agreement void for illegality, will equity aid the assignee in the enforcement of the mortgage security.[5]

§ 192. Payments to Mortgagee, after assignment. —Payments upon a bond secured by mortgage by the mortgagor to the mortgagee, made after an assignment thereof by the latter, when made in good faith, without notice, actual or constructive, of the assignment, are valid. The sums thus paid in good faith are credited on the bond and

[1] Davis *v.* Leopold, 87 N. Y. 620.

[2] Van Wyck *v.* Baker, 16 Hun, 168; Davis *v.* Leopold, 87 N. Y. 620.

[3] Feltz *v.* Walker, 49 Conn. 93.

[4] Pendleton *v.* Fay, 2 Paige's Ch. 201, where an insolvent trustee assigned a mortgage purporting on its face to be given to him as trustee, partly in payment of his debt to the assignee, and partly for cash, which he applied to his private use.

[5] Johnson *v.* Bush, 3 Barb. Ch. 207; Dewitt *v.* Brisbane, 16 N. Y. 508; Talmage *v.* Pell, 7 Ib. 328; Leavitt *v.* Palmer, 3 Ib. 1; Schroeppel *v.* Corning, 5 Denio, 236; s. c. 6 N. Y. 107; Adams *v.* Rowan, 8 S. & M. 624.

mortgage, as against any assignee thereof.[1] Nor is a payment made before maturity evidence of bad faith; nor the non-production of the bond and mortgage and indorsement of such payment thereon when made. No presumption that the transaction is not bona fide arises where, upon payment in full of the debt, the securities are not re-delivered and no satisfaction of the mortgage executed, and no inquiries made relative thereto. Mere failure to produce such non-negotiable securities is not of itself sufficient to charge the mortgagor with the duty of investigation.[2] In order to protect himself from bona fide payments by the mortgagor to the mortgagee after assignment, an assignee of a bond and mortgage should notify the mortgagor himself.[3] Where a bond and mortgage were assigned for value, but were not delivered at the time, being held as collateral security for a note by a third party, who was subsequently paid by the mortgagor, an assignee, upon foreclosure, having taken such mortgage with the same equities as his assignor, is subject to a credit on the mortgage of the amount of the note paid.[4] In the leading case of Matthews *v.* Walwyn, a non-negotia-

[1] Foster *v.* Beals, 21 N. Y. 247; Trustees of Union College *v.* Wheeler, 61 Ib. 88, 111; Van Keuren *v.* Corkins, 66 Ib. 771; Jones *v.* Johnson, 6 Johns. Ch. 427; Insurance Co. *v.* Smith, 2 Barb. Ch. 82; Mitchell *v.* Burnhan, 44 Me. 303; Bank *v.* Anderson, 14 Iowa. 544; Johnson *v.* Carpenter, 7 Minn. 176; Williams *v.* Sorrell, 4 Ves. 389. In Trustees etc. *v.* Wheeler, supra, the court say: "Before the assignment the mortgagee had complete power to discharge the debt as well as the mortgage, either in part or absolutely. That power must be presumed to continue until notice to the contrary. By means of it he may violate the equities of third parties, and his conduct may so react on his own interests as to discharge his lien. If an assignee sees fit to leave him this apparent authority, he can not complain of its exercise as to persons acting in good faith, but must be regarded as represented by and identified with the mortgagee."

[2] Van Keuren *v.* Corkins, 66 N. Y. 77; Foster *v.* Beals, 21 Ib. 247.

[3] Reed *v.* Marble, 10 Paige, 408; James *v.* Corey, 2 Cowen, 258; N.Y. Life Ins. Co. *v.* Smith, 2 Barb. Ch. 82; Meghan *v.* Mills, 9 Johns. 64; Say *v.* Dascomb, 1 Hill, 552; Briggs *v.* Dorr, 19 Johns. 95; Van Keuren *v.* Corkins, supra; Heermans *v.* Ellsworth, 64 N. Y. 159.

[4] Kamena *v.* Huelbig, 23 N. J. Eq. 78.

ble bond and mortgage securing the same were fraudulently assigned by the mortgagee, who thereafter received large payments which should have been credited upon the mortgage debt. The assignee subsequently sought to foreclose. The recovery upon the mortgage in equity was restricted to what was really due upon the bond, following the rule in law.[1]

§ 193. RELEASE BY MORTGAGEE, AFTER ASSIGNMENT.—The rule sustaining payments made by the mortgagor to the mortgagee after assignment but before notice thereof, is applied in cases where the mortgagee, after such assignment, and before notice to the mortgagor, releases the whole or a part of the land covered by such mortgage. An assignee of such bond and mortgage is bound by such release as he is by payments of the mortgagor made bona fide. The rule, however, is restricted in its application to persons executing the mortgage directly or indirectly through trustees.[2] A bond and mortgage were assigned by an administrator of a deceased mortgagee, who subsequently by mistake discharged the mortgage without receiving payment. The discharge was duly recorded, and the premises were then sold to a bona fide purchaser for value, without notice. The assignee of the securities brought suit to foreclose. The effect of the recording of the release of the mortgage being to cancel the record thereof, the subsequent purchaser for value in good faith, without notice, was protected.[3] But the cancellation of a mortgage on the record is only prima facie evidence of its discharge, and

[1] 4 Ves. 126. Referring to this case, the United States Supreme Court, in Carpenter *v.* Longan, 16 Wall. 271, say: "The principle is distinctly recognized that the measure of liability upon the instrument secured is the measure of the liability chargeable upon the security. The condition of the assignee can not be better in equity than it is at law. So neither can it be worse. Upon this ground we place our judgment."

[2] Jones *v.* Smith, 22 Mich. 260; Trustees of Union College *v* Wheeler, 61 N. Y. 88; Stocks *v.* Dobson, 4 De G. M. & G. 11.

[3] Ely *v.* Scofield, 35 Barb. 330; Swartz *v.* Leist, 13 Ohio St. 419.

the fact that such cancellation was procured or made by fraud or accident, or in mistake, is subject to proof by an assignee or party interested.[1] Nor will such cancellation affect the right to hold other collateral securities, so long as the debt secured by such mortgage remains unpaid.[2]

CHAPTER XIX.

BONDS AND MORTGAGES AS COLLATERAL SECURITY.

§194. The use of bonds and mortgages as collateral security.
195. The pledge of bonds and mortgages by delivery.
196. The equities to which the pledgee is not subject.
197. The pledgee's equities, as against fraudulent releases.
198. The pledgee's rights, in cases of fraud, misappropriation, etc.
199. Realization of the securities by pledgee.
200. Pledgor's rights upon payment of debt.

§ 194. The use of Bonds and Mortgages as Collateral Security.—The use of bonds and mortgages, as collateral security for other obligations, is general in the states where this form of security is adopted. The pledgee, receiving the same in good faith for a valuable consideration properly assigned, is vested with the legal title to the bond and mortgage, and entitled to enforce the mortgage security in equity with the same rights as a purchaser for value, in good faith, and is also subject to the like equities. Such a non-negotiable bond, as the evidence of a debt or obligation, and the mortgage given as collateral security for its payment, are the subject of pledge.[3] The mortgage se-

[1] Trenton Banking Co. *v.* Woodruff, 2 N. Y. Eq. 125; Lilly *v.* Quick, Ib. 97; Miller *v.* Wack, 1 Ib. 214.

[2] Hollis *v.* Insurance Co., 12 Phila. 321. And the same rule applies to parties receiving subsequent assignments of the collateral security. Ibid.

[3] Campbell *v.* Parker, 9 Bosw. 322.

curity creating a specific lien on the land, the assignment carries the legal estate to the pledgees, and is governed by rules generally applicable to mortgages of a legal or equitable interest in real property.[1] A bond and mortgage transferred by an assignment absolute in terms, but in fact as collateral security for a promissory note made by the assignor, by the terms of which the assignor is given authority to sell the collateral securities upon default in payment of the note, is a pledge and not a mortgage or sale of such collateral securities.[2] The pledgor remains the general owner of the collateral where the title has not been passed, the pledgee holding a special property therein as security for the advances made.[3]

§ 195. The pledge of Bonds and Mortgages by delivery.—A bond as a non-negotiable chose in action, together with the mortgage given to secure its payment, may be assigned as collateral security by a mere delivery thereof.[4] Such collateral securities may be held by the pledgee under a verbal agreement, as security for the payment of a claim of a third person as for his own.[5] The satisfaction of the claim of one creditor by the pledgor is without effect upon the right to retain possession of the collaterals by the other, or his enforcement of the mortgage security, upon default.[6] The benefit of such securities may follow by implication to several creditors, as where certain bonds and mortgages were assigned in trust as collateral security for the payment of sterling bonds issued by a corporation, the holders for value of the bonds, having acquired an imme-

[1] Clark *v.* Henry, 2 Cow. 324; Carr *v.* Carr, 52 N. Y. 251; Slee *v.* Manhattan Co., 1 Paige Ch. 48, 50; Rice *v.* Dillingham, 73 Me. 59.

[2] Campbell *v.* Parker, 9 Bosw. 322.

[3] O'Dougherty *v.* Remington Paper Co., 81 N. Y. 496.

[4] Kamena *v.* Huelbig, 23 N. J. Eq. 78; Galway *v.* Fullerton, 17 Ib. 389; Wilson *v.* Troup, 3 Cow. 231; Jackson *v.* Willard, 4 Johns. 41; Runyan *v.* Mesereau, 11 Ib. 534; Prescott *v.* Hull, 17 Ib. 292.

[5] Champney *v.* Coope, 32 N. Y. 543; Harbeck *v.* Vanderbilt, 20 Ib 395; Hubbell *v.* Blakeslee, 71 Ib. 63.

[6] Ibid.; Kellogg *v.* Ames, 41 N. Y. 259.

diate beneficial interest in the collateral securities, became in effect the assignees and purchasers for value of every bond and mortgage embraced in the trust deed.[1] Where, however, a bond and mortgage are executed for the purpose of raising money for the mortgagor, and there is no delivery to or consideration paid therefor by the mortgagee, such securities have no vitality until assignment and delivery, and even in the hands of an assignee for value without notice, the transaction is not given a retroactive operation to the time of the execution and record of such securities, so as to cut out equities arising in the interval between such time and the assignment in fact.[2]

§ 196. THE EQUITIES TO WHICH THE PLEDGEE IS NOT SUBJECT.—The pledgee for value of a non-negotiable bond, secured by mortgage, without notice of antecedent equities, is protected as against secret equities. Where a bond and mortgage were executed by the wife of one partner to the other partner for the purpose of raising part of the capital of the partnership, and were assigned as collateral security to an indorser of an accommodation note, upon which the desired money was raised, the latter, having subsequently paid the note, was entitled to foreclose the mortgage security, free from the secret equity alleged between the parties thereto that the mortgage should be paid from the profits of the business.[3] Nor will the fact that a bond and mortgage, delivered for the temporary accommodation of the mortgagee, by reason of false representations as to his solvency and upon his agreement to use them as collateral security only, were assigned absolutely to a bona fide assignee, without notice of the secret agreement, be any defense against such assignee in an action to foreclose.[4]

In order to provide for the payment of three bills of ex-

[1] Palmer *v.* Yates, 2 Sandf. 137.
[2] Schaeffer *v.* Reilly, 50 N. Y. 61.
[3] Ferdon *v.* Miller, 34 N. J. Eq. 10.
[4] Jacobson *v.* Dodd, 32 N. J. Eq. 403; Duncan *v.* Gilbert, 29 Ib. 521.

change, the drawer executed a bond and mortgage, to be sold for cash, and the proceeds applied in payment of the bills. The mortgagee (the acceptor) without the consent of the mortgagor or of the holders of the bills, pledged the bond and mortgage as collateral security to a bank for the payment of any and all sums of money which were then or might be thereafter due by him, the bank having no notice of the condition upon which the mortgage was executed. The pledgee subsequently purchased the securities absolutely, the mortgagee giving credit to the mortgagor upon an account between them for the amount so realized. The bills of exchange having been negotiated, the holders thereof sought to restrain the bank from selling the land, but claiming under the mortgage they were not allowed to repudiate its form, nor could they avoid the legal consequences resulting therefrom, and as the mortgage contained no reference to the condition upon which they relied, they were estopped to dispute the bank's title. A transfer of a mortgage by one having an apparently unrestricted power of disposition thereof to an innocent person advancing value, conveys it free from any claims of secret cestuis que trust.[1] The rule is enforced relative to collateral agreements of which a pledgee has no notice, where the bond and mortgage are delivered with a declaration of "no defense."[2]

§ 197. THE PLEDGEE'S EQUITIES, AS AGAINST FRAUDULENT RELEASES.—Where the holder of a bond and mortgage, having assigned the securities to a third person as collateral for a valuable advance in good faith, subsequently received from the mortgagor a conveyance of his equity, and executed a release of the mortgage securities, the land was held still subject to the equitable claims of the bona fide pledgee for value.[3] Such release of mortgage securi-

[1] First National Bank *v.* Corry, 22 Hun, 339; Dillaye *v.* Commercial Bank, 51 N. B. 345; Greene *v.* Warwick, 64 Ib. 220.

[2] Riggs *v.* Pursell, 89 N. Y. 608.

[3] Brown *v.* Blydenburgh, 7 N. Y. 141.

ties, and execution of a conveyance by the mortgagor, without the production of the bond and mortgage, is of itself suspicious enough to put the mortgagor upon inquiry, and if unexplained, to render him chargeable with knowledge of the fraudulent character of the transaction. His liability upon his personal obligation still remains valid and enforcible.[1] The like rule applies as against a person advancing money on a bond and mortgage, who fails to require the production thereof. By his neglect he becomes chargeable with notice of any defect in the title of his assignor.[2]

§ 198. THE PLEDGEE'S RIGHTS, IN CASES OF FRAUD, MISAPPROPRIATION, ETC.—A bond and mortgage executed and delivered, without consideration, to be used for a specific purpose, must be applied exclusively thereto. Any other disposition of it is a fraudulent misappropriation, against which the mortgagor is entitled to relief in equity.[3] A bond and mortgage were executed as collateral security for the performance of a contract, which was subsequently canceled. The pledgee, in the meantime, fraudulently assigned the bond and mortgage. An action to foreclose the mortgage was brought by the assignee, but he was not allowed to enforce the security, the pledgees having no title thereto, which was not defeasible by cancellation of the contract, and could not convey any greater title.[4] Under the restricted rule prevailing in certain states, the pledgee or sub-pledgee of a bond and mortgage, receiving the same as collateral security for an antecedent debt, without more, is not a holder for value, in the usual course of business, nor protected from equities arising subsequently to the giving of a certificate of "no defense" by the mortgagor.[5] The pledgee of a bond and mortgagee, however, is not re-

[1] Brown *v.* Blydenburg, 7 N. Y. 141.

[2] Kellogg *v.* Smith, 26 N. Y. 20.

[3] Andrews *v.* Torrey, 14 N. J. Eq. 355; Phillips *v.* Thompson, 2 Johns. Ch. 423.

[4] Wanzer *v.* Cary, 76 N. Y. 526.

[5] Ashton's App., 73 Pa. St. 153; McConnell *v.* Wenrich, 16 Ib. 365.

sponsible for any misappropriation of the money loaned thereon, where the transaction of pledge has been made with an agent, entrusted with the documents of title and apparent absolute ownership for the purpose of selling the same in the market.[1]

The sub-pledgee of bonds and mortgages, although holding the same for value, in good faith, and without notice, is subject to like equities as the pledgee, and in cases of fraudulent pledge, not within the established rules of estoppel in pais, can acquire no greater right to such securities than were acquired under the original loan. The leading case in New York upon the question of the equities to which assignees for value of bonds and mortgages are subject, arose out of a sub-pledge of such securities. In Bush *v.* Lathrop[2] a non-negotiable bond for $1,400 was given, secured by a mortgage conditioned to pay the bond. The bond and mortgage were assigned as collateral security for a negotiable note for less than one-fifth the face of the bond, the assignment, which otherwise was absolute in form, reciting the amount of the note as the consideration thereof, but containing a covenant on the part of the mortgagor that the whole amount named in the bond, and interest, was due. Shortly afterwards, the collateral securities were fraudulently assigned by the pledgee for a consideration of $1,475, with a covenant on his part that $1,400 and interest was due thereon. Subsequently the assignees reassigned the securities to the defendant for a consideration of $1,488, paid chiefly in money and the residue in notes, the transaction being bona fide and without notice. The property was valued at $2,000. The administrator of the deceased mortgagor tendered to the last assignee the amount of the principal note and interest for which the bond and mortgage were pledged in the first instance, and upon refusal to re-deliver the security, brought an action

[1] Westervelt *v.* Scott, 11 N.J Eq. 78. [2] Bush *v.* Lathrop, 22 N. Y. 535.

therefor. The court below found for the sub-pledgee, but the judgment was reversed at general term, and the Court of Appeals affirmed the latter decision.

§ 199. Realization of the Securities by Pledgee. —The pledgee, in the exercise of powers granted by contract to sell or collect collaterals, must act in good faith. Where a contract of pledge provides that such securities may be sold, the pledgor should make previous demand of payment of the original debt.[1] A transfer thereof under such power, to the obligor and mortgagor, or to a person in his interest, for a sum sufficient only to pay the principal debt, but grossly inadequate to the real value of the collateral securities, the mortgagor or person in his interest buying for the purpose of cancelling the same, amounts to a conversion, and the pledgee may be sued for the damages resulting from such wrongful sale.[2] It is the duty of the pledgee, where a bond and mortgage are pledged as collateral security to secure the payment of a promissory note previously given to the plaintiff, such being the express condition of the bond to produce the note for cancellation at the time judgment is entered on the bond, for it may have passed into the hands of a holder for value, without notice.[3] The pledgee, in enforcing the mortgage security, is not subject to a defense of usury in the principal demand, a promissory note, for which the bond and mortgage were assigned as collateral security.[4] And where a mortgage was made to secure a loan, and other collateral securities are given, the equity of a subsequent mortgagee of part of the same property to require such securities to be marshalled in his favor will not follow them into the hands of an assignee for value, without notice.[5]

§ 200. Pledgor's rights upon payment of Debt. —Where a mortgagor has paid to a pledgee the amount of

[1] Campbell *v.* Parker, 9 Bosw. 322.
[2] Ibid.
[3] Matteson *v.* Matteson, 55 Wis. 540.
[4] Stevens *v.* Reeves, 33 N. J. Eq. 427.
[5] Reilly *v.* Mayer, 12 N. J. Eq. 55.

the note made by the mortgagee, to secure the payment of which the bond and mortgage executed by such mortgagor had been pledged, and received the same and the collaterals, he is subrogated as against a subsequent assignee of the bond and mortgage, chargeable with notice that the mortgagee, at the time of the assignment, had not possession thereof, to the rights of the payee of the note, and is allowed to set-off, in a suit in equity to foreclose by the assignee, the full amount of the note and interest, although he took up the same for less than its face. The title of the assignee being subject to the pledge, it was immaterial that he had no notice thereof, by record or otherwise; nor was the title of the mortgagor subsequently redeeming the bond and mortgage, so pledged, affected by payment of the indebtedness.[1] Where a pledgee, holding a bond and mortgage as collateral security, brought suit to foreclose the security, claiming only the amount of the debt and obtained a decree for a lien on the land for the amount due and for a sale, and the pledgor paid the amount due and then brought his own suit in equity to foreclose, for the full amount of the bond, he was allowed to recover, the former decree upon the special title of the pledgee not operating as a bar to the suit by the pledgor as the general owner of the securities.[2] An equitable mortgage of title deeds was made to secure a loan of £3,000. The pledgee sub-pledged the mortgage securities for a loan to himself of £1,200. The sub-pledgee failed to inform the mortgagor, and subsequently, upon a promise of the pledgee to substitute other equally valuable securities, surrendered the mortgage securities to the pledgee. The mortgagor then paid his loan to the pledgee, and received the deeds. The substituted securities proving worthless, the sub-pledgee sought to enforce his claim as against the mortgagor. The want of notice and his surrender of the deeds were sufficient to defeat his claim.[3]

[1] Kamena *v.* Huelbig, 23 N. J. Eq. 98.

[2] O'Dougherty *v.* Remington Paper Co. 81 N. Y. 496.

[3] In re Lord Southampton's Est., L. R. 16 Ch. D. 178.

17

PART III.

THE PARTIES TO THE INSTRUMENT.

CHAPTER XX.

THE CONTRACT OF THE SURETY.

§201. The parties to the instrument.
202. The contract of the surety.
203. The contract, as proved by parol, or by terms of the instrument.
204. The general liability of the surety.
205. The surety's liability on invalid loans, or forged or fraudulent paper.
206. The surety's liability on official bonds.
207. The liability of married women and minors as sureties.
208. Obligations of sureties for married women and minors.

§ 201. THE PARTIES TO THE INSTRUMENT.—The rights and liabilities of parties to negotiable instruments are governed by the order of their names on the paper, and by their relations to each other, and the holder thereof. Where the payment of such instruments is secured by the deposit of collateral securities held by either, or one or more of the parties thereto, as is frequently the case, the rights accruing in relation to such collateral securities are governed by equitable rules, which have been so uniformly enforced as to become part of the commercial law of the country. The principal relations of parties to the instruments thus created are those of the holder thereof, the maker, surety, indorser, and guarantor, and drawer, drawee and acceptor, and payee of bills of exchange. The equitable principle of subrogation to collateral securities is applied

in these relations; and also in the case of co-sureties, the further equitable principle of contribution as to collateral securities from the common principal, as founded upon principles of natural justice. The holder of the bill or note, or creditor, or the surety or indorser or acceptor, holding collateral securities, are subject in respect thereto, to the liabilities of pledgees. The same rules as to care and diligence in the preservation and collection of collateral securities, and the results of fraud and bad faith in connection therewith, resulting in loss, follow as in the cases of pledge of like collaterals. Both at law and in equity, the rights of parties to the instrument to the benefit of collateral securities are preserved and enforced.

§ 202. THE CONTRACT OF SURETYSHIP.—The contract or undertaking of a surety is a contract to be answerable for the payment of some debt, or the performance of some act or duty, in case of the failure of another person, who is himself primarily responsible for the payment of such debt, or the performance of the act or duty.[1] Such contracts may be arranged in three divisions: 1, those in which there is an agreement to constitute, for a particular purpose, the relation of principal and surety, to which agreement the creditor thereby secured is a party[2]; 2, those in which there is a similar agreement between the principal and surety only, to which the creditor is a stranger; but in which the creditor, having notice of such relations between the parties, will not be at liberty to do anything to the prejudice of the rights of the surety, or to refuse (when all his own just claims are satisfied) to give effect to them[3]; and 3, those in which, without any such contract of suretyship, there is a

[1] Addison on Cont. 555.

[2] Duncan *v.* North and South Wales Bank, L. R. 6 App., 1, 11, 12 (Earl Cairns, Lord Chancellor); Owen *v.* Hanan, 3 Mac. & G. 378; Newton *v.* Chorlton, 10 Hare, 646; Pearl *v.* Deacon, 24 Beav. 186; s. c. 1 DeG. & J. 461.

[3] Davis *v.* Stainbank, 6 D. M. & G. 694; ex parte Higgins, 2 Glyn & J. 93; Liquidators *v.* Liquidators, L. R. 7 H. L. 348.

primary and a secondary liability of two persons for one and the same debt, the debt being, as between the two, that of one of those persons only, and not equally of both, so that the other, if he should be compelled to pay it, would be entitled to reimbursement from the person by whom (as between the two) it ought to have been paid.[1]

§ 203. THE CONTRACT, AS PROVED BY PAROL, OR BY TERMS OF THE INSTRUMENT.—The contract of suretyship between the principal and surety is an independent and collateral undertaking from that of the principal debt, although its terms may in part be inferred from the instrument upon which the surety is bound. Proof of the fact of suretyship by parol evidence is permitted as not coming within the objection that it tends to vary a written instrument. Evidence of such fact is received, although upon the face of the instrument the parties appear as joint debtors.[2] Such proof is without effect, however, as to the

[1] Tindal *v.* Brown, 1 Tenn. R. 170; s. c. 2 Ib. 186; ex parte Younge, 3 Y. & B. 40; Clark *v.* Devlin, 3 B. & P. 366.

[2] Ward *v.* Stout, 32 Ill. 399; Barry *v.* Ransom, 12 N. Y. 462; Hubbard *v.* Gurney, 64 Ib. 457; Calvo *v.* Davies, 73 Ib. 216; Palmer *v.* Purdy, 83 Ib. 144; Graves *v.* Johnson, 48 Conn. 160; McKee *v.* Hamilton, 33 Ohio St. 7; Wharton *v.* Woodburn, 4 Dev. & B. 507. Contra: Yates *v.* Donaldson, 5 Md. 401; Walker *v.* Bank of Montgomery, 12 S. & R. 382; Lewis *v.* Hinchman, 2 Pa. St. 418. Duncan *v.* N. & S. W. Ry. Co., L. R. 6 App. 1; Liquidators *v.* same, L. R. 7 H. L. 348; Davies *v.* Stainbank, 6 D. M. & G. 694; Deering *v.* Winchelsea, 2 B. & P. 270; ex parte Hippins, 2 Glynn & J. 93; Sterling *v.* Forrester, 3 Bligh, 575. In Palmer *v.* Purdy, supra, the New York Court of Appeals (Finch, J.) say: "This is not a rule which in any manner assumes to alter or modify the original contract or the common liability. That remains as an unchanged fact, and may be enforced as freely and perfectly as ever against all the debtors. The change effected is that, as between themselves, one becomes a surety for the rest, because of a valid agreement by which they become primarily liable for the debt, and bound to pay in exoneration of their associate; and this fact being fairly and fully brought to the knowledge of the creditor, he is bound to respect the rights of the debtor who has become a surety and acquired the right to be protected as such. When, therefore, by the agreement of the debtors among themselves, it is sought to

principal contract entered into, but operates, when knowledge of it is chargeable to the creditor, to prevent him from changing the contract in any essential particular, or from making a different agreement with the principal debtor, without the knowledge and consent of the surety, or from releasing any collateral security held for the payment of the debt. Such knowledge also imposes the duty of enforcing the contract, as against the principal, when matured, upon request of the surety.[1] Although as to such principal contract, the mere knowledge of the holders of a bill or note that the parties thereto stand in the relation of principal and surety, is not of itself sufficient to show that the creditor consented to deal with them in such capacities, where the note is executed and delivered by the sureties apparently as principals.[2] Parol evidence is admitted both in equity and at law to establish the true relations of parties to such instruments.[3]

The addition, by one of the makers of negotiable paper of the word "surety," to his signature, charges the holder thereof with notice of the relationship.[4] Such addition to a signature raises the presumption that the bill or note is given for value by the other makers, and that they are the principal debtors.[5]

invest one or more of them with new equitable rights outside of the original contract by notice to the creditor of the later arrangement, such notice must be be definite and distinct, and so given as to fully apprize the creditor of the new agreement in fact made, and the changed attitude of the debtor claiming the rights of a surety."

[1] Hubbard *v.* Gurney, 64 N. Y. 469; Harris *v.* Brooks (Shaw, C. J.) 21 Pick. 195; Goodman *v.* Litaker, 84 N. C. 8; Bank *v.* Hoge, 6 Ohio, 17; Wythes *v.* Labouchere, 3 DeG. & J. 593.

[2] Rogers *v.* Tapp, 57 Tex. (13 Rep. 157); Reynolds *v.* Tapp, 5 Wend. 501.

[3] Nemicewicz *v.* Gahn, 3 Paige, 614; Barry *v.* Rauson, 12 N. Y. 462; Hubbard *v.* Gurney, 64 Ib. 467; Davies *v.* Barrington, 30 N. H. 517; Grafton Bank *v.* Kent, 4 Ib. 221; Mariners' Bank *v.* Abbott, 28 Me. 280; Wilson *v.* Green, 25 Vt. 450; Branch Bank *v.* James, 9 Ala. 949; Hott *v.* Bodey, 18 Pa. St. 207; Core *v.* Wilson, 40 Ind. 204.

[4] Hunt *v.* Adams, 5 Mass. 358; Robinson *v.* Lyle, 10 Barb. 512; Rogers *v.* Tapp, supra.

[5] Farmers's Nat. Bank *v.* Stover, 60 Cal. 389.

§ 204. THE GENERAL LIABILITY OF THE SURETY.—The measure of liability of a surety is fixed by the terms of the instrument which he has signed. His undertaking is not to be enlarged or varied by judicial construction, but construed most strictly and favorably for his interests.[1] In case of doubt as to his liability, it is generally, if not universally resolved in his favor.[2] It is only to the extent, and in the manner, and under the circumstances pointed out in his obligation, that the surety is bound. Nor is it sufficient that he may sustain no injury by a change in the contract, or that it may even be for his benefit. The surety has a right to stand upon the very terms of the contract; and if he does not assent to any variation of it, and a variation is made, it is fatal.[3] Where the contract of suretyship is for a certain sum only, the surety is only liable to the limit agreed upon. In such cases, if the debt or defalcation amounts to a sum larger than that named in the contract, the surety is only liable to the amount named in his bond; if the debt or defalcation be less, then to the sum only.[4]

[1] United States *v.* Boyd, 15 Pet. 187; Mix *v.* Singleton, 86 Ill. 194; People *v.* Tomkins, 74 Ib. 482; Myers *v.* National Bank, 78 Ib. 257; Cooper *v.* People, 85 Ib. 417; Philips *v.* Singer Manuf. Co., 88 Ill. 205; Winston *v.* State, 73 Ind. 175; Home Savings Bank *v.* Traube, 75 Mo. 199; Morgan *v.* Martien, 32 Ib. 438; Orrick *v.* Vahey, 49 Ib. 431; St. Louis. *v.* Sickles, 52 Ib. 122; New London County Bank *v.* Mitchell, 15 Conn. 219; Ludlow *v.* Simond, 2 Caines' Cas. 1; Crist *v.* Burlingame, 62 Barb. 351; McClusky *v.* Cromwell, 11 N. Y. 593; Ward *v.* Stahl, 81 Ib. 406; Gates *v.* McKee, 13 Ib. 232; Rochester City Bank *v.* Elwood, 21 Ib. 88; National Mechanics' Banking Corporation *v.* Conkling, 90 N. Y. 116; Jennery *v.* Olmstead, 90 N. Y. 363; Paw Paw *v.* Eggleston, 25 Mich. 36; Johnston *v.* Kimball, 39 Ib. 137; Detroit Savings Bank *v.* Ziegler, 49 Mich. 457 (14 Rep. 658); State *v.* Cutting, 2 Ohio St. 1; Liverpool Water Co. *v.* Atkinson, 6 East, 597; Pearsall *v.* Summersett, 4 Taunt. 593; Pybus *v.* Gibbs, 6 El. & Bl. 903; London Ass. Co. *v.* Bold, 6 Q. B. 514; Hassell *v.* Long, 2 M. & S. 370; Heppin *v.* Cooper, 2 B. & A. 431.

[2] Dedham Bank *v.* Chickering, 4 Pick. 314; Still *v.* Vance, 62 Ill. 52.

[3] Miller *v.* Stewart, 9 Wheat. 681, 703 (Story, Jus.)

[4] Ex parte Snowden, L. R. 17 Ch. D. 44, 47.

§205. The Surety's liability on invalid Loans, or forged or fraudulent Paper.—Where a bona fide advance has been obtained upon a negotiable instrument, signed by parties as principal and sureties, from a corporation without authority to loan money for the purpose desired, it is no defense to a surety bound upon such obligation that the act of loan was beyond the authority of the corporation, where the money has actually been received. The equities, as between the parties, are entirely with the corporation.[1] Where directors of a railroad company became sureties upon contracts of the company which were ultra vires, so that no recovery could be had as against the company, the liability of the sureties thereon was enforced, their contract being independent and collateral, in favor of innocent third parties who had advanced money thereon, in good faith, without notice.[2] A surety, although holding collateral security from his principal, is not bound upon a note, which, under statutory enactments, is void.[3] Where a surety executes a bond in the belief that the names thereon are genuine, and one turns out to be a forgery, if the payee or holder has accepted the instrument in good faith, for value, without notice of the forgery, the surety is bound.[4] A surety who signs a promissory note upon condition that before delivery, an additional name should be procured, is bound to a holder for value, before maturity, taking the same without notice of the condition.[5] The liability of a surety was enforced, where a promissory note, in the

[1] In re Coltman, L. R. 19 Ch. D. 64, 71; Jones *v.* National Building Ass., 94 Pa. St. 215.

[2] Yorkshire Ry. Co. *v.* Maclure, L. R. 19 Ch. D. 478; German Mining Co.'s Case, 4 D. M. & G. 19; Chambers *v.* Manchester etc. Ry. Co., 5 B. & S. 588, 612.

[3] Nourse *v.* Pope, 13 All. 87.

[4] Helms *v.* Wayne Agricultural Society, 73 Ind. 325; Wayne etc. Society *v.* Cordwell, Ib. 555; Stoner *v.* Milliken, 85 Ill. 218, overruling Seeley *v.* People, 27 Ib. 173; City of Chicago *v.* Gage, 95 Ill. 593; Stern *v.* People, 102 Ib. 540; State *v.* Baker, 64 Mo. 167.

[5] Clarke *v.* Bryce, 64 Geo. 486; Brown *v.* Kent County, 42 Mich. 501; Washington Probate Court *v.* St. Clair, 52 Vt. 24.

terms "I promise to pay to the order of myself," was signed by two persons, and placed by one as accommodation paper in the hands of the other, and was transferred by the holder, for value, in violation of the agreement between the parties.[1]

§ 206. THE SURETY'S LIABILITY ON OFFICIAL BONDS.— The liability of sureties upon official bonds is strictly construed, and does not extend beyond the letter of the contract. Their obligation is regarded as strictissimi juris, and nothing can be added thereto by way of presumption or construction. The sureties in such cases are bound to a certain extent only; and any substantial change in the office of the principal, without the sureties' consent, discharges them from liability. The general language used in a contract of suretyship, following a recital of the particular office which the principal is to fill, is generally restricted by the particular words of the recital.[2] The liability of sureties was not enforced where a bond was given for a bookkeeper, who was subsequently promoted to the position of teller, and as such officer embezzled money coming into his hands[3] nor where an assistant clerk had been promoted to bookkeeper,[4] nor where the change was from actuary to bookkeeper and clerk,[5] nor where a clerk of a court was appointed receiver of a trust fund, under an order of court, and misappropriated the money received to his own use.[6]

But the rule stated is not applied in cases where the

[1] First Nat. Bank *v.* Fowler, 36 Ohio St. 524.

[2] Home Savings Bank *v.* Traube, 75 Mo. 199; State *v.* Sandusky, 46 Ib. 381; State *v.* Cutting, 2 Ohio, 1; Detroit Savings Bank *v.* Ziegler, supra; Paw Paw *v.* Eggleston, 25 Mich. 36, 40; Detroit *v.* Weber, 29 Ib. 24; Johnston *v.* Kimball, 39 Ib. 1; Tradesmen's Bank *v.* Woodward, Anthon (N. Y.) 300; National Mech. Banking Ass. *v.* Conkling, 90 N. Y. 116; McCluskey *v.* Cromwell, 11 N. Y. 593; Weonston *v.* State, 73 Ind. 175.

[3] National Mech. Banking Association *v.* Conkling, 90 N. Y. 116.

[4] Manufacturers' Bank *v.* Dickerson, 44 N. J. L. 449.

[5] Jennery *v.* Olmstead, 90 N.Y. 363.

[6] Rogers *v.* Odom, 18 S. C. (15 Rep. 607); Hammer *v.* Kaufman, 39 Ill. 87; Waters *v.* Carroll, 9 Yerg. 102; State *v.* Blackmore, 7 Heisk. 638.

principal assumes additional duties in a new and independent office, while continuing the discharge of the duties of the former position, and the default occurs in the discharge of the duties of the latter.[1] As where a collector of certain rates was also appointed collector of other independent rates, such appointment formed no defense to an action against his sureties for a default in the first office, caused by a defalcation.[2] Nor is the liability of a surety for a bookkeeper in a bank, who also acted as teller, affected by the additional employment, unless the errors were connected with the duties of teller, or caused by his employment as such.[3] And the same rule was applied in the case of sureties for a teller, afterwards appointed bookkeeper.[4] The surety's liability is not affected, where the additional employment is only temporary. A receiving teller, thus assisting a general teller, embezzled moneys coming into his possession as such assistant teller. His surety's liability was unaffected by the merely temporary employment.[5]

§ 207. THE LIABILITY OF MARRIED WOMEN AND MINORS AS SURETIES.—Under the common law, a married woman could not bind her estate as surety; but this disability has been generally removed. She has usually as to her separate property the powers of a femme sole,[6] and may incur

[1] Skillett *v.* Fletcher, L. R. 2 C. P. 469; United States *v.* Kirkpatrick, 9 Wheat. 720; People *v.* Vilas, 36 N. Y. 459; Supervisors *v.* Clarke, 25 Hun, 386; Hatch *v.* Attleborough, 97 Mass. 533; Commonwealth *v.* Holmes, 25 Gratt. 771.

[2] Skillett *v.* Fletcher, supra.

[3] Home Savings Bank *v.* Traube, 76 Mo. 199; Rochester City Bank *v.* Elwood, 31 N. Y. 88.

[4] Batchelor *v.* National Bank, 78 Ky. 435.

[5] Detroit Savings Bank *v.* Ziegler, Mich., supra.

[6] Pelzer *v.* Campbell, 15 S. C. 582; Mayo *v.* Hutchinson, 57 Me. 547; Derring *v.* Boyle, 8 Kan. 529; Wicks *v.* Mitchell, 9 Ib. 88; Major *v.* Holmes, 124 Mass. 108; Kenworthy *v.* Sawyer, 125 Ib. 28; Goodnow *v.* Hill, Ib. 588; Williams *v.* Wimston, 35 Ohio St. 296, overruling Levi *v.* Earl, 30 Ib. 147, and Rice *v.* Railroad Company, 32 Ib. 380. The rule in Penn. was changed by the act of April 10, 1879, P. L. 16. Wiggin's App. 100 Pa. St. 155 (15 C. L. N. 67); Davis *v.* Statts, 43 Ind. 103; Illinois Rev. Stats. 1874, c. 68, p. 576.

liability as a surety for third persons. Her obligations in this respect are enforced in law and equity,[1] except where the obligation is shown to have been assumed under duress.[1] A married woman is entitled, where she has mortgaged her real estate to secure a debt of her husband, to the benefit as surety of the equitable principle that a creditor must first exhaust the property of the principal debtor before resorting to that of the surety, if he can do so without loss or injury to himself.[2]

Persons under age can not assume the liabilities of suretyship, and such contracts are held to be void, especially where the undertaking of the minor is manifestly against his interest.[4] Where such contracts, however, are in fact beneficial to the minor, they may be ratified by some distinctive act on his part, if there be a clear knowledge of the want of binding effect of the original contract.[5] A note made by an infant may form a good consideration for another note given after his majority in renewal of the same.[6]

§ 208. Obligations of Sureties for married women and minors.—In states where the rule prevails of the disability of married women to enter into contracts, the liability of third persons is not affected, who have become sureties for performance or payment. The undertaking of such sureties, being a separate and independent contract, is not affected or rendered void, although the personal engagement

[1] Woolsey *v.* Brown, 74 N. Y. 82; Com. Exchange Nat. Bank *v.* Babcock, 42 Ib. 613; Carpenter *v.* O'Dougherty, 50 Ib. 660; Maxon *v.* Scott, 55 Ib. 247; Manhattan Nat. Bank *v.* Thompson, 58 Ib. 80; Third Nat. Bank *v.* Blake, 73 Ib. 260.

[2] Loomis *v.* Ruck, 56 N. Y. 462.

[3] Niemcewicz *v.* Gahn, 3 Paige, 614; s. c. 11 Wend. 312; Wright *v.* Austin, 56 Barb. 13; John *v.* Reardon, 11 Md. 465; Allis *v.* Ware, 27 Minn. 166; Wilcox *v.* Todd, 64 Mo. 388.

[4] Robinson *v.* Weeks, 56 Me. 102; Chandler *v.* McKinney, 6 Mich. 217; Maples *v.* Wightman, 4 Conn. 376.

[5] Owen *v.* Long, 112 Mass. 403; Hinely *v.* Margaritz, 3 Pa. St. 428; Fetrow *v.* Wiseman, 40 Ind. 148.

[6] Baldwin *v.* Vandusen, 37 N. Y. 487.

of the principal be worthless.[1] A building association made a loan to a married woman, upon a mortgage of her separate estate, requiring her husband also to execute a bond for the amount of the loan. Although the contract could not be enforced personally against the woman, an action upon the bond given by her husband, who was regarded as a surety, was supported, although he received none of the consideration, the contract having been made in good faith, upon a valuable advance.[2] The receipt of a note from a married woman by a sheriff, is not a discharge of her surety, where taken as a favor by the officer, and not by an act of duress.[3] A third person, who has fraudulently procured a minor to indorse a note in blank, is liable for the amount of the same when in the hands of a holder for value, before maturity, without notice, although the first holder was chargeable with notice of the infirmity of the indorsement.[4]

[1] Weed Sewing Machine Co. *v.* Maxwell, 63 Mo. 486; State *v.* Waggoner, 45 N. J. L. (14 Rep. 467.)

[2] Wiggins' App. 100 Pa. St. (15 C. L. N. 69.)

[3] St. Alban's Bank *v.* Dillon, 30 Vt. 122.

[4] Lobdell *v.* Baker, 3 Met. 469; Thrall *v.* Newell, 19 Vt. 202; Polhill *v.* Walter, 3 B. & Ad. 114.

CHAPTER XXI.

THE SURETY'S RIGHT TO COLLATERALS.

§209. The creditor's responsibility, holding collaterals.
210. The creditor's primary resort to securities of principal.
211. Equitable limitations of the rule.
212. Subrogation of sureties to collateral securities of creditor.
213. The securities to which surety is subrogated.
214. Equitable conditions of subrogation to securities.
215. The surety's subrogation to the debt or judgment.
216. The surety's right of subrogation, when defeated.
217. Subrogation of creditor to collateral securities of surety.
218. The subrogation of creditors, as against pledgees.
219. Application of proceeds from collaterals.
220. The creditor's enforcement of the principal note.
221. The recovery of creditor, as against surety.

§ 209. THE CREDITOR'S RESPONSIBILITIES, HOLDING COLLATERALS.—The relationship of creditor, principal debtor, and surety, where the former has received from the debtor collateral security for the performance of the principal promise in addition to the personal liability of the surety, creates a limited responsibility on the part of the creditor as to the care and diligence required in the safe keeping and realization thereof. The creditor, chargeable with knowledge that one or more of the parties bound upon the principal bill or note are sureties, is bound to act in good faith in his dealings with such collaterals, if he would enforce the personal liability of the surety upon the maker's default. Such securities are regarded in equity as given as much for the benefit of the surety as for the creditor, and the former's right to be subrogated thereto, upon payment of the debt, upon the principal's default, is unquestioned. With this

beneficial interest in the collateral securities, the surety is entitled to be discharged pro tanto, if the creditor, by waste or neglect so gross as to amount to fraud, or unauthorized or fraudulent dealing therewith, impairs or destroys their value. The creditor stands in the relation as to such collaterals of a secondary or quasi-trustee; and although the receipt thereof in no way limits his right, upon default, to an action at law against the parties bound upon the principal instrument, yet in equity, he may be required, where not injurious or prejudicial to his interests, to resort thereto rather than to the personal responsibility of the surety.[1]

§ 210. The Creditor's primary resort to securities of Principal.—Upon equitable principles, the burden of the debt is thrown primarily upon the estate and securities of the principal debtor, and such estate is exhausted in exoneration of that of the surety. The equity of the surety in this respect is preferred as against creditors holding general liens thereon, and is enforced, in cases where not injurious to the creditor, although process has been issued against the surety. Such process will be retained until the property and securities of the principal debtor have been applied in payment.[2] Where the surety has placed securities with those of principal in the hands of the creditor, he is entitled to require the securities of the principal first applied to the debt, and if both are sold, to have the same ap-

[1] Black River Bank *v.* Page, 44 N. Y. 453; Wooten *v.* Buchanan, 49 Miss. 386; Allen *v.* Woodward, 125 Mass. 400; West Boston Savings Bank *v.* Thompson, 124 Ib. 506, 514; Warner *v.* Beardsley, 8 Wend. 194; Bangs *v.* Story, 7 Hill, 250; Schroeppel *v.* Shaw, 3 N. Y. 446; Manning *v.* Shotwell, 4 N. J. L. 584; Hall *v.* Hoxey, 84 Ill. 618; Priest *v.* Watson, 75 Mo. 315; Clow *v.* Derby Coal Co. 98 Pa. St. 432; Phares *v.* Barbour, 49 Ill. 370, 375.

[2] Wilcox *v.* Todd, 64 Mo. 388; Wright *v.* Austin, 56 Barb. 13; Niemcewicz *v.* Gahn, 3 Paige, 614; s. c. on appeal, 11 Wend. 312; John *v.* Reardon, 11 Md. 465; Wooten *v.* Buchanan, 49 Miss. 386. The principle was applied in favor of an indorser in Union Bank *v.* Laird, 2 Wheat. 390.

plication of their proceeds.[1] A surety upon a note, secured by a deed of trust of the principal maker, is entitled, after its maturity, to require that the real estate security of the principal should be first exhausted for its payment; and the trustee, in the absence from the country of the holder of the note, may properly make a sale of the property upon the request of the surety. Such surety may himself bid upon the property in order to be protected from liability.[2] A valid agreement may be made by a surety with a creditor that the latter shall bring a bill in equity against the principal debtor to collect the debt from securities held by him, or on his behalf, although the surety has not paid the debt.[3] A judgment having been entered upon default in the payment of notes secured by mortgage, an appeal was taken upon bond with surety. Pending appeal, the creditor sold the property covered by the mortgage, applying the proceeds thereof to the payment of the notes. As this was all that the surety could have done had he been subrogated to such collateral securities, a judgment against him for a deficiency arising at such sale was enforced.[4]

§ 211. EQUITABLE LIMITATIONS OF THE RULE.—The creditor's resort primarily to the collateral securities of the principal debtor held by him, is subject to the equitable rule that such proceedings will be equally as available as an action at law against the surety, and would as fully indemnify the creditor, subjecting him to no delay, and exposing him to no loss.[5] The surety may, at any time after

[1] Vartie *v.* Underwood, 18 Barb. 561; Strong *v.* Wooster, 6 Vt. 536. The same principle is applied between lien creditors, in adjusting their claims on funds in Pennsylvania. Delaware Canal Co. App. 38 Pa. St. 512; McLellan's App. 76 Ib. 235; Horning's App. 90 Ib. 388; McIlvain *v.* Mutual Ins. Co. 93 Ib. 30; Hoff's App, 84 Ib. 40.

[2] Booth *v.* Wiley, 102 Ill. 41.

[3] Speiglemeyer *v.* Crawford, 6 Paige, 254.

[4] Marchand *v.* Frellsen, 105 U. S. 423; Wharn *v.* Irvin, 27 La. Ann. 706; Landry *v.* Vicker, 30 Ib. 1041.

[5] Gary *v.* Cannon, 3 Ired. Eq. 64; Irick *v.* Black, 17 N. J. Eq. 189; Wright *v.* Austin, 56 Barb. 13; Sterling *v.* Forrester, 3 Bligh. 590.

the debt becomes due and payable discharge it by payment, and thus become entitled to all the collateral securities held by the creditor.[1] The mere receipt of securities from the principal has no effect upon the obligation of the surety, and is no defense against an action of the payee against the surety upon the note for the payment of which the securities were pledged.[2] Nor is such a defense available to an indorser of a promissory note, as where a bank discounting a note relied upon collateral securities of the principal, deposited with the creditor. An indorsee for value of the note is entitled to look to all the parties thereto for payment, irrespective of any collateral securities held by any of them.[3] It is no defense to an action at law for a surety on a promissory note to show that the bank holding the same, after maturity received deposits from the principal largely in excess of the amount of the note.[4] Nor is the liability of the surety affected by a depreciation in the value of collateral securities in the interval between the maturity of the debt and the commencement of an action against the surety.[5]

§ 212. Subrogation of Sureties to Collateral securities of Creditor.—The surety is entitled, upon payment, to be subrogated to the collateral securities held by the creditor from the principal debtor, whether such securities were received at the time the contract of suretyship was entered into or subsequently, or without the knowledge of the surety. This right of the surety is one not founded upon contract, but is supported upon prin-

[1] Jones *v.* Fincher, 15 Ind. 308; Irick *v.* Freehold Nat. Bank Co. 37 N. J. L. 307; Schroeppel *v.* Shaw, 3 N. Y. 446; and after payment may file a bill to have the securities applied to his relief. Houser *v.* King, 76 Va. 731.

[2] Allen *v.* Woodward, 125 Mass. 400.

[3] West Boston Savings Bank *v.* Thompson, 124 Mass. 506, 514.

[4] Steiner *v.* Erie Dime Savings Bank, 98 Pa. St. 591.

[5] Brick *v.* Freehold Nat. Bank Co. 37 N. J. 307; Schroeppel *v.* Shaw, 3 N. Y. 446.

ciples of equity and natural justice, and the tendency is to enlarge and extend its application.[1] The right is applied in favor of each of several sureties upon payment[2] and is assignable by the surety, the assignee becoming entitled to the equitable rights of the surety.[3] The right of subrogation however, is limited to the indebtedness of the principal to the surety on all accounts at the time the subrogation is sought. If the surety is indebted to the principal, though in a distinct account, to an amount equal to what he has paid for his principal, he has no right of subrogation.[4] And the right, being a mere equity, is denied in all cases where its exercise would produce injustice.[5] But where the principal himself is a surety upon the obligation upon which the

[1] Knighton *v.* Curry, 62 Ala. 404; Smith *v.* Harrison, 33 Ib. 706; Talbott *v.* Wilkins, 31 Ark. 411; Jaques *v.* Faekney, 64 Ill. 87; Bishop *v.* O'Connor, 69 Ib. 431; Richeson *v.* Crawford, 94 Ib. 165; Beaver *v.* Slanker, Ib. 175; Jones *v.* Fincher, 15 Ind. 308; Zook *v.* Clemmer, 44 Ib. 15; Patterson *v.* Pope, 5 Dana, 243; Rice *v.* Downing, 12 B. Mon. 45; Scott *v.* Featherston, 5 La. Ann. 306; Magee *v.* Leggett, 48 Miss. 139; Lee *v.* Griffin. 31 Ib. 632; Osborne *v.* Noble, 46 Ib. 449; Taylor *v.* Jeter, 23 Mo. 244; Berthold *v.* Berthold, 46 Ib. 577; Allison *v* Sutherlin, 50 Ib. 274; Easton *v.* Hasty, 6 Neb. 419; Smith *v.* McLeod, 3 Ired. Eq. 390; Irick *v.* Black, 17 N. J. Eq. 189; Clason *v.* Morris, 10 Johns. 524; Martin *v.* Howard, 12 Hun, 16; Townsend *v.* Whitney, 15 Ib. 93; Hayes *v.* Ward, 4 Johns. Ch. 130; Green *v.* Millbank, 3 Abb. N. Cas. 138; s. c. 56 How. 382; Fielding *v.* Waterhouse, 40 N. Y. Super. Ct. 424; Mathews *v.* Aikin, 1 N. Y. 595; Lewis *v.* Palmer, 28 Ib. 271; Corey *v.* Leonard, 56 N. Y. 494; Butler *v.* Birkey, 13 Ohio St. 514; Cottrell's App. 23 Pa. St. 294; McCormick *v.* Irwin, 35 Ib. 111; Muller *v.* Wadlington, 5 S.C.342; Harlan *v.* Sweney, 1 Lea, 682; Allen *v.* Henley, 2 Ib. 141; Horton *v.* Bond. 28 Gratt. 815; Dent *v.* Wait, 9 W. Va. 41; Lidderdale *v.* Triggs. 12 Wheat. 594; in re Babcock, 3 Story, 393; Hodgson *v.* Shaw, 3 M. & K. 183; Craythorne *v.* Swinburne, 14 Ves. 159.

[2] Clapp *v.* Lebanon Bank, 46 Pa. St. 88; Sears *v.* Leforce, 17 Iowa, 473; Brown *v.* Ray, 18 N. H. 102; Paris *v.* Hulett, 26 Vt. 308; Lane *v.* Stacy, 8 Allen, 41, a case of joint indorsers.

[3] York *v.* Landis, 65 N. C. 535; Elwood *v.* Diefendorf, 5 Barb. 398.

[4] Neff *v.* Miller, 8 Pa. St. 347; Coates' App. 7 W. & S. 99; Bailey *v.* Broomfield, 20 Pa. St. 41.

[5] Cassidy *v.* Keeley, 13 Phila. 112.

surety borrows the money with which to pay the debt, the right of subrogation is not affected.[1]

The right of subrogation of the surety extends to the collateral securities received by the creditor from the principal debtor subsequently to the creation of the relationship of creditor, principal debtor, and surety. The securities thus received are, like those received at the inception of the contract, in the nature of a trust or quasi-trust fund for the benefit of the sureties as well as of the creditor. The indemnity resulting from the possession of such collateral securities enures to the relief of the one as of the other. The surety's bargain is, that the securities taken by the creditor shall be transferred to him if and when he is called upon to make payment, and it is the duty of the creditor to keep such securities intact, whether received at the time of the suretyship, or subsequently. Even where the creditor has burthened such securities with new advances to the principal debtor, the equities of the surety are preferred.[2]

§213. The Securities to which Surety is subrogated.—The surety, upon payment of the debt, is also subrogated in equity to all such securities of the creditor as, under technical rules of law, become extinct upon such payment, as well as to such independent collateral securities as may be held by the creditor.[3] The surety is entitled, upon payment, to the benefit of an attachment against the principal obtained by the creditor, and the levy of an execution

[1] Owen's App. 11 Weekly Notes Cas. 488.

[2] Hardin *v.* Eames, 4 Bradw. 153; Phares *v.* Barbour, 49 Ill. 370, 375; Rogers *v.* Trustees, 46 Ill. 428; Osborne *v.* Noble, 46 Miss. 449; Baker *v.* Briggs, 8 Pick. 121; Merchants' Bank *v.* Baker, 4 Met. 164; Guild *v.* Butler, 127 Mass. 386; Forbes *v.* Jackson, L. R. 19 Ch. D. 615; Duncan *v.* Bank, L. R. 11 Ch. D. 88; s.c. 6 App 1; Pledge *v.* Buss, Johns. Ch. 663, 668; Williams *v.* Owen, 13 Sim. 597; Farebrother *v.* Woodhouse, 23 Beav. 18; Newton *v.* Chorlton, 10 Hare. 646.

[3] Allison *v.* Sutherlin, 50 Mo. 274; Furnold *v.* Bank, 44 Ib. 336; Lathrop's App. 1 Pa. St. 512: and the right may be enforced at law. Arnot *v.* Woodburn, 35 Mo. 99. Contra: Bigelow *v.* Cassidy, 26 N. J. Eq. 557.

thereon. Such attachment is a security within the rule.[1] And to the lien of an execution;[2] and to a replevin bond;[3] but not to a distress warrant.[4] And under a Pennsylvania statute authorizing a stay of execution for a year upon giving security, the surety for the original debt, upon payment, is entitled to the remedy of the creditor upon the stay.[5] A surety is entitled, upon the same terms, to the benefit of a mortgage or other charge, held by the creditor as collateral security, and to the proceeds of the enforcement of the security, when it has been converted into cash, or to any surplus remaining after discharging prior encumbrances.[6] The special liens and priorities vested in the government of the United States and the several state commonwealths are, upon equitable principles, preserved for the benefit of sureties who have paid judgments or other obligations of their principals to the federal or state authorities. The surety's right of subrogation thereto is undoubted.[7] A provision in a statute giving a lien to a state upon the recording of an official bond, with sureties, until the conditions thereof should be complied with, is enforced for the benefit of sureties paying a deficiency of such official, the intention of the

[1] Brewer *v.* Franklin Mills, 42 N. H. 292; Edgerly *v.* Emerson, 23 Ib. 355.

[2] Watts *v.* Kinney, 3 Leigh, 272; Hunter *v.* Keller, 3 W. & S. 401.

[3] Glass *v.* Pullen, 6 Bush, 346.

[4] Hall *v.* Hoxsey, 84 Ill. 618.

[5] Schnittzell's App. 49 Pa. St. 23; Potts *v.* Nathans, 1 W. & S. 155; Burns *v.* Bank, 1 P. & W. 395.

[6] Gerber *v.* Sharp, 72 Ind. 553; Fawcette *v.* Kennedy, 33 Ala. 261; Osborne *v.* Noble, 46 Miss. 449; Storms *v.* Storms, 3 Bush, 77; Jones *v.* Fincher, 15 Ind. 308; Lewis *v.* Palmer, 28 N. Y. 271; City Nat. Bank, *v.* Dudgeon, 65 Ill. 11; Rogers *v.* School Trustees, 46 Ib. 428; Phares *v.* Barbour, 49 Ib. 370; Jaques *v.* Fackney, 64 Ib. 87; Beaver *v.* Slankey, 94 Ib. 175; Hayes *v.* Ward, 4 Johns. Ch 123; Root *v.* Bancroft, 10 Met. 48; Hodgson *v.* Shaw, 3 M. & K. 190; Copis *v.* Middleton, 1 Turn. & R. 224.

[7] United States *v.* Herron, 20 Wall. 251; Hunter *v.* United States, 5 Pet. 173; s. c. 5 Mason, 62; United States *v.* Preston, 4 Wash. 446; Cochrane *v.* Cushing, 124 Mass. 219; Smith *v.* Hodson, 50 Wis. 279; Enders *v.* Brine, 4 Rand. 438; Dias *v.* Bouchard, 3 Edw. 485; Grider *v.* Payne, 9 Dana, 188; Regina *v.* Salter, 1 H. & N. 274; King *v.* Bennett, Wightwick, 2, 6.

Legislature being to give a collateral security not only for the benefit of the state, but as indemnity to the sureties in case of default.[1]

§ 214. EQUITABLE CONDITIONS OF SUBROGATION TO SECURITIES.—An essential condition of the right of a surety to subrogation to securities held by the creditor from the principal debtor is, that he shall first pay the debt upon which he is bound. Until this has been done, the surety has no equitable right to the securities, and is not entitled to require the creditor to surrender them to him. In no sense, are such securities his, until payment. Nor will a satisfaction and discharge of a part of the debt entitle a surety to demand such collateral securities, as the right of the creditor to retain possession of all securities until fully paid, is preferred.[2] Equity, however, will afford relief to a surety, against whom a judgment has been entered and is being pressed by execution, even before payment of the debt, upon a bill against the creditor and the principal debtor, for subrogation to collateral securities held by the creditor, so as to prevent any dealing therewith to his prejudice.[3] The right of subrogation may be lost by such delay upon the part of a surety to claim it as to amount to laches; especially where to permit it, after a lapse of years, third persons, who had acquired liens and rights thereon in good faith, would be injured.[4]

But the payment of a debt for which a third person is bound by a mere volunteer or stranger, is not sufficient to

[1] Richeson *v.* Crawford, 94 Ill. 165; s. c. 101 Ib. 351.

[2] Hoover *v.* Epler, 52 Pa. St. 522; Neptune Ins. Co. *v.* Dorsey, 3 Md. Ch. 334; Union Bank *v.* Edwards, 1 Gill & J. 346; Glass *v.* Pullen, 6 Bush, 316; Ryner *v.* Ryner, 6 Watts, 221; Capen's App. 28 Conn. 220; Magee *v.* Leggett, 48 Miss. 139; Duncan *v.* Mobile R. R. Co. 3 Woods, 567, 581; ex parte Brett, L. R. 6 Ch. D. 841.

[3] Moore *v.* Topliff, 107 Ill. 241, 249.

[4] Gring's App. 89 Pa. St. 336; Douglass' App. 48 Ib. 223.

entitle such persons to the benefits of the equitable principle of subrogation to the creditor's collateral securities. It is only in cases where the person advancing money to pay the debt of a third party stands in the relationship of a surety to the principal debtor, or where one person is compelled to pay to protect his own individual interests, that subrogation to such securities held by the creditor is permitted, in the absence of any agreement for such subrogation.[1] Subrogation, however, may be provided for, by agreement, where such payments are made by volunteers or strangers,[2] and, in the absence of contract, the intention of such parties that there should be such subrogation will control.[3] Where a debtor, being pressed to give security for his debt, surrendered his property in pursuance of a contract between the parties, to a third person, who agreed to pay the debt, and gave his own promissory note therefor, the creditor may maintain an action thereon, he being a holder for value.[4]

[1] Sanford *v.* McLean, 3 Paige Ch. 122; Shinn *v.* Budd, 14 N. J. Eq. 238; Hayes *v.* Wood, 4 Johns. Ch. 130; Beaver *v.* Slanker, 94 Ill. 175, 183; Hough *v.* Etna Ins. Co. 57 Ib. 318; Young *v.* Morgan, 89 Ib. 199; Bishop *v.* O'Connor, 69 Ib. 431, 437; Hoover *v.* Epler, 52 Pa. St. 522; Mozier's App. 56 Ib. 76; Wallace's Est. 59 Ib. 401: Webster's App. 86 Ib. 409; Wormer *v.* Waterloo Society, 62 Ia. 699; Bacon *v.* Goodnow, 59 N. H. 415.

[2] Worner *v.* Waterloo etc. Society, supra; Burr *v.* Smith, 21 Barb. 262.

[3] Dodge *v.* Freeman's Savings and Trust Co. 93 U. S. 379; Pacific Bank *v.* Mitchell, 9 Met. 297; Swope *v.* Leffingwell, 72 Mo. 348; Montgomery Bank *v.* Albany City Bank, 7 N. Y. 459; White *v.* Knapp, 8 Paige, 175; Harbeck *v.* Vanderbilt, 20 N. Y. 398; Litheap *v.* Wilt, 4 Phila. 64; Wilson *v.* Murphy, 1 Ib. 203; Green *v.* Key, 3 B. & Ad. 313; Deacon *v.* Stodhart, 2 Man. & G. 317; Jones *v.* Broadhurst, 9 M. G. & S. 173 In Dodge *v.* Freedman's etc. Co, supra, the court (Hunt J.) say: "If the maker had anything to say or do in the premises, it was to present himself with the money when the notes matured, pay them, and secure his obligations. Failing in this, he leaves the securities to be dealt with as others interested may choose. There would appear, therefore, in the nature and propriety of the subject, to be no objection to a transfer to a third person paying the money, instead of a technical payment of and discharge of the notes."

[4] Parson *v.* Clark, 132 Mass. 569.

§ 215. THE SURETY'S SUBROGATION TO THE DEBT OR JUDGMENT.—The equitable principle of subrogation under which the surety is entitled to collateral securities held by the creditor, upon payment of the principal debt, is also applied in equity, to the debt itself or the judgment obtained thereon, and to remedies upon such debt or judgment as against the principal debtor. This equitable claim of the surety is not only that of subrogation, pure and simple, but it also includes the right to a formal assignment of the debt or judgment by the creditor. The surety, by performing his contract of payment, upon default of his principal, the latter's obligation is, as to the creditor, discharged, but is kept alive, as between the creditor, debtor and surety, for the purposes of securing the rights of the last.[1] Nor will a surety upon a judgment note, lose his right of subrogation to the judgment entered thereon, because the fact of his suretyship does not appear in the recitals of such judgment.[2] The right of subrogation of the surety to the judgment of the creditor upon payment is not defeated by the failure to execute a formal instrument of assignment by the creditor.[3] A creditor, paid by the proceeds of collateral securities deposited by a surety, is

[1] Knauf's App. 91 Pa. St. 78; Bailey *v.* Brownfield, 20 Ib. 41; Richter *v.* Cummings, 60 Ib. 441; Hill *v.* Manser, 11 Gratt. 522; McDougald *v.* Dougherty, 14 Ga. 674; Jones *v.* Fincher, 15 Ind. 308; Braught *v.* Griffith, 16 Iowa, 26; Johnson *v.* Belden, 49 Ib. 301; Speiglemeyer *v.* Crawford 6 Paige, 57; Hayes *v.* Ward, 4 Johns. Ch. 123; Davis *v.* Perrine, 4 Edw. Ch. 65; Ellsworth *v.* Lockwood, 42 N. Y. 89; Hinckley *v.* Kreitz, 58 Ib. 583, 591; Fielding *v.* Waterhouse, 40 N. Y.; Sup. Ct. 424; Kummel *v.* Lowe, 28 Minn. 265; Smith *v.* Rumsey, 33 Mich. 183; Nelson *v.* Fry, 16 Ohio St. 553. Even where the judgment was paid in ignorance of the right of subrogation. Dempsey *v.* Bush. 18 Ohio St. 376; Magee *v.* Leggett, 48 Miss. 139; Bowen *v.* Haskins, 45 Ib. 186; Mitchell *v.* DeWitt, 25 Tex. (supp.) 180; Watts *v.* Kinney, 3 Leigh, 27; Lowe *v.* Newbold, 4 Jones Eq. 212. Where the creditor resorts to the collaterals deposited by the surety, he must preserve the original debt, for in equity the surety is entitled thereto. To release an indorser is so to impair a debt as to discharge a surety. Denny *v.* Lyon, 38 Pa. St. 98.

[2] Owen's App. 11 W. N. C. 488.

[3] Duffield *v.* Cooper, 87 Pa. St. 443.

required to preserve his original demand against the principal debtor for the benefit of the surety.[1] The rule is also applied to a partner who upon dissolution, by assuming and agreeing to pay all the debts of the firm, has become the principal debtor. Where in such case, the retiring partner has been obliged to pay such debts, he is entitled to subrogation as against the defaulting partner,[2] and also as against the creditors of such partner.[3]

Under the common law, where a judgment has been rendered upon the debt against the principal, and the same has been paid by a surety, and where the debt itself had been paid to the creditor by the surety, both judgment and debt being respectively extinguished, the surety was allowed no subrogation thereto. Even an assignment of such debt or judgment to a third person is ineffective to secure continued vitality so as to be of value to the surety. This rule prevails also in certain states. Generally, the surety is entitled, by statutory provisions, to an assignment of the judgment against the principal debtor, where he has paid the same.[4]

§ 216. THE SURETY'S RIGHTS OF SUBROGATION, WHEN DEFEATED.—A surety, however, may estop himself by his

[1] Denny *v.* Lyon, 38 Pa. St. 98.

[2] Scott's App. 88 Pa. St.; Frou's Est. 73 Ib. 459; Burnside *v.* Fetzner, 63 Mo. 107, 111; Crafts *v.* Mott, 4 N. Y. 604.

[3] Fessler *v.* Hickernell, 82 Pa. St. 150.

[4] Jones *v.* Davids, 4 Russ. 297; Copis *v.* Middleton, 1 Turn. & R. 224, 231; Woffington *v.* Sparks, 2 Ves. 569; Craythorne *v.* Swinburne, 14 Ves. 159; Hodgson *v.* Shaw, 3 M. & K. 183; Armitage *v.* Baldwin, 5 Beav. 278; Jones *v.* Davids, 4 Russ. 277. Where a surety compounds a debt owing by his principal, and takes an assignment thereof to a trustee for himself, he can only claim as against his principal the sum he had actually paid. Reed *v.* Norris, 2 M. & C. 361. Dennis *v.* Rider, 2 McLean, 451; Foster *v.* Trustees, 3 Ala. 430; Morrison *v.* Marvin, 6 Ib. 767; Veach *v.* Wickersham, 11 Bush, 261; Holmes *v.* Day, 108 Mass. 563; Hammatt *v.* Wyman, 9 Ib. 138; Adams *v.* Drake, 11 Cush. 504. No action at law in Iowa. Johnson *v.* Belden, 49 Iowa, 301. A statute relating to sureties only is not applied to indorsers. Dibrell *v.* Dandridge, 51 Miss. 55.

acts to claim the enforcement of the judgment against his principal, as where it is satisfied and discharged, by reason of a compromise of the claim, brought about by the active efforts of the surety himself,[1] and his subrogation to the judgment is not permitted as against his principal, where there is clear proof of an agreement of the parties that it should be discharged for all and every purpose.[2] And laches will defeat the claims of a surety to subrogation to a judgment, as in a case where a surety as joint judgment debtor was forced under execution to pay the whole debt, but neglected to have the judgment assigned to his use for more than a year after its payment. Meanwhile the property had been sold, and the surety claimed to be subrogated to the rights of the creditor under the judgment as against subsequent judgment creditors.[3]

§ 217. Subrogation of Creditor to collateral securities of Surety.—The equitable principle of subrogation to collateral securities is enforced in favor of the creditor as well as the surety. Where the surety himself has received such securities from the principal debtor on account of the obligation assumed, equity creates a quasi trust in relation thereto, in favor of the creditor and of cosureties, until the debt be discharged. The surety has no right to discharge or defeat such trust. The resort, however, of the creditor for the payment of his debt to such collateral securities held by the surety, where the former is not a party to any agreement by which they have been placed in the hands of the latter, is optional with him. The creditor is under no obligation to rely upon such collateral securities, in place of enforcing the personal obligations of the principal and surety, and without his consent, he is not required primarily to attempt to realize his debt from them.

[1] Fielding *v.* Waterhouse, 40 N. Y. Sup. Ct. 424.

[2] Ibid; Harbeck *v.* Vanderbilt, 20 N. Y. 395.

[3] Owen's App. 11 W. N. C. 488; Gring's App. 89 Pa. St. 336.

The right of subrogation thereto is only enforced where the creditor chooses to avail himself of it. It is his privilege to avail himself of such securities, and not an absolute duty, of which a court of equity will require the performance.[1] The right to such subrogation by the creditor is strictly limited to cases where the claim as against the surety is valid and existing, and capable of immediate enforcement;[2] nor can the creditor acquire any greater interest in such securities than the surety himself had.[3] Where such securities are held by the surety against loss by reason of an existing liability, fixed and presently enforceable, the surety may, without and before payment, unless otherwise agreed, apply the securities to the satisfaction of the principal debt upon which he is obligated. To this equity the creditor is also entitled by subrogation, and by bringing a bill in equity to enforce the same is able to secure payment of the debt and to release the surety.[4]

The right of the creditor to such subrogation to collateral securities is not affected by the fact that he was not in-

[1] Thornton *v.* National Bank, 71 Mo. 231; Hauser *v.* King, 76 Va. 731; Leibert *v.* True, 8 Kansas, 52; Ohio Life Ins. Co. *v.* Ledyard, 8 Ala. 866; Van Orden *v.* Durham, 35 Cal 136; in re Fickett, 72 Me. 266; Pool *v.* Doster, 59 Miss. 258; Clark *v.* Ely, 2 Sandf. Ch. 166; Ten Eyk *v.* Holmes, 3 Ib. 428; Curtis *v.* Tyler, 9 Paige, 432; Bank of Auburn *v.* Throop, 18 Johns. 505; Moses *v.* Murgatroyd, 1 Johns. Ch. 129; Vail *v.* Foster, 4 N.Y. 312; Crosby *v.* Crafts, 5 Hun, 327; Brown *v.* Ray, 18 N.H. 102; Price *v.* Truesdell, 28 N. J. Eq. 200; Wilcox *v.* Fairhaven Bank, 7 Allen, 270; Eastman *v.* Foster, 8 Met. 19; Rice *v.* Dewey, 13 Gray, 47; Kelly *v.* Herrick, 131 Mass. 373; Owens *v.* Miller, 29 Md. 144; Rice's App. 79 Pa. St. 168; Roberts *v.* Colvin, 3 Gratt. 358; Curry *v.* McCauley, 11 Fed. Rep. 365. A surety who had taken out an insurance policy on the life of his principal as security, received the money from the company. So far as the same was not required as indemnity for the surety, the proceeds were appropriated in payment of the debt. Lea *v.* Hinton, 5 DeG. M. & G. 823; Wright *v.* Morley, 11 Ves. 22; Drysdale *v.* Piggott, 22 Beav. 238.

[2] Constant *v.* Matteson, 22 Ill. 546.

[3] Bush *v.* Stamps, 26 Miss. 463.

[4] Houser *v.* King, 76 Va. (15 Rep. 63); Constant *v.* Matteson, 22 Ill. 546; Belcher *v.* Hartford Bank, 15 Conn. 353; New London Bank *v.* Lee, 11 Ib. 118, 122.

formed at the time the contract of suretyship was entered into that the surety held such securities, and therefore no reliance was placed upon them in making his loan and advances.[1] Nor that he has not reduced his claim against the principal to judgment, nor exhausted his legal remedies.[2] And where the security is a mortgage, it is immaterial that the same is made in terms simply for the indemnity of the surety.[3] Even where, before the surety is called upon to pay the debt, the mortgagor has sold the land, and conveyed the estate to a third person for value.[4] And a surety may, upon agreement, transfer his collateral securities to the creditor, enabling him to retain possession thereof until the debt of the principal be paid.[5]

§ 218. The subrogation of Creditors, as against Pledgees.—The principle of subrogation to securities held by sureties, or parties in the position of sureties, is applied where an agent, secured by a pledge of negotiable bonds, obtained a loan of money in his own name, the money being handed to and used by his principal. The creditor was given a right of subrogation to the collaterals, although the loan was made on the credit of the agent, betwen whom and the principal equities existed. The creditor was also allowed to receive a dividend upon such securities upon a foreclosure of a mortgage securing their payment.[6] The like rule was applied to a guarantor of such bonds who was obliged to pay the debt of the company issuing the same.[7]

[1] Seibert *v.* True, 8 Kan. 52; Cromwell's App. 9 W. & S. 305; Krame's App. 37 Pa. St. 71; Rice's App. 79 Ib. 168; Moorehead *v.* Duncan, 82 Ib. 488; Curtis *v.* Tyler, 9 Paige, 431.

[2] Safford *v.* Wade, 51 Ala. 214.

[3] New Bedford etc. Inst. *v.* Fairhaven Bank, 9 Allen, 75; Curtis *v.* Tyler, 9 Paige Ch. 432; Moses *v.* Murtatroyd, 1 Johns. Ch. 119; Phillips *v.* Thompson, 2 Ib. 418; Ten Eyck *v.* Holmes, 3 Sandf. Ch. 428; Clark *v.* Ely, 2 Ib. 166; Riddle *v.* Bowman, 25 N. H. 236; Aldrich *v.* Martin, 4 R. I. 520; Ohio Ins. Co. *v.* Ledyard, 8 Ala. 166.

[4] Gossin *v.* Brown, 11 Pa. St. 527.

[5] Calkins *v.* Lockwood, 17 Conn. 174.

[6] Rice's App. 79 Pa. St. 168.

[7] Penn. R. R. Co. *v.* Pemberton R. R. Co. 28 N. J. Eq. 338.

A former guardian gave negotiable bonds as collateral security to his sureties to indemnify them. Both the principal and sureties became insolvent, and a portion only of the debt was paid by the sureties. A guardian, succeeding to the trust, was given the same rights as a creditor, and an order was entered to have the securities sold, and the proceeds applied to the payment of the balance of the debt.[1] The trust character of collateral securities held by a surety from his principal for his indemnity from liability, is not changed by a sale, and the acceptance by him of promissory notes from the purchasers thereof. Where such notes are pledged for an antecedent debt, without any further consideration, the pledgee is not, in New York, a holder for value, in the usual course of business, and was subject to the prior equities of the holders of the notes upon which the surety was bound.[2]

§ 219. Application of proceeds from Collaterals.—The creditor holding collateral securities from the principal to secure the payment of several notes is entitled, in the absence of any stipulation or agreement, to apply them or their proceeds, in the event that sufficient is not realized to discharge the whole amount of the indebtedness to such of the notes as he may select.[3] Nor is it material that some of the notes so secured bear the names of sureties, while others do not. The creditor has the election, subject to agreement, to apply such securities or the proceeds thereof to the payment primarily of such of the notes as do not bear the names of sureties. Until the surety has paid the full amount of his liability on the notes for which such securities are deposited, he has no claim to any of the proceeds.[4] The right of elec-

[1] Kelly *v.* Herrick, 131 Mass. 373.
[2] Clark *v.* Ely, 2 Sandf. Ch. 166.
[3] National Bank *v.* Bigler, 83 N.Y. 51, 64; Field *v.* Holland, 6 Cranch, 8.
[4] Wilcox *v.* Fairhaven Bank, 7 Allen, 270; Reed *v.* Boardman, 20 Pick. 411; Richardson *v* Washington Bank, 3 Met. 236; Harding *v.* Tifft, 75 N. Y. 461; Allen *v.* Culver, 3 Den. 285; Stone *v.* Seymour, 15

tion of the creditor is not affected by the unknown equities of third parties.[1] Where the creditor, however, holds securities from the principal debtor to cover all obligations held by him, and there are several sureties upon different notes, the proceeds of such securities should be divided pro rata.[2]

The rule relative to the application of the proceeds of securities held by a creditor, in the absence of agreement, is applied in favor of sureties also. Where a surety has assumed liability on several notes, for which he holds security, he may apply the proceeds thereof in payment of such notes as he may desire.[3] A deed of trust executed by the principal debtor for the benefit of a surety, was delivered to a third person, holding other indebtedness against the debtor. In a contest between the two, as to the application of the proceeds arising from a sale of the security, the equitable right of the surety that the particular indebtedness upon which he was liable should be first paid, was preferred.[4]

§ 220. The Creditor's enforcement of the principal Note.—The contract of the surety upon a negotiable promissory note is, that the maker of the note, the principal debtor, will pay the same at maturity. The creditor holding such notes is bound to present the same for payment in due course, and upon the principal's default in payment, the surety becomes at once liable to pay. The creditor is under no obligation or duty to use special or active diligence to collect the note from the principal debtor in order to charge the surety, since the obligation of the latter is at once to pay the debt, upon which he may

Wend. 20; Copis *v.* Middleton, 1 Turn. & R. 224; Hodgson *v.* Shaw, 3 M. & K. 183.

[1] Harding *v.* Tifft, 75 N. Y. 461.

[2] Breidenbecker *v.* Lowell, 32 Barb. 9.

[3] Norton *v.* Plumb, 14 Conn. 517.

[4] Kassing *v.* International Bank, 74 Ill. 16.

resort to any suit or action to which the creditor was entitled. A failure to sue the principal, although no notice of the default of the debtor be sent to the surety, is not sufficient to affect the liability of the surety upon the principal obligation. Where there are more than two sureties upon such note, the creditor may sue both or either, at his pleasure. No complaint can be made by sureties, as either of them may pay the debt and become entitled to be subrogated to the rights, remedies, and collateral securities.[1] Statutory provision is made in some states that a surety who fears the insolvency of his principal or other sufficient equitable cause, may, by serving a proper notice upon the creditor, require him to commence an action against the principal debtor forthwith, upon default at maturity. Where the creditor fails to perform his duty in this respect, and loss results to the surety by reason thereof, as where the principal debtor has in fact become insolvent, the surety is discharged to the full extent of his loss.[2] The

[1] Neal *v.* Freeman, 85 N. C. 352; Thornton *v.* same, 63 Ib. 211: Deal *v.* Cochran, 66 Ib. 269; Peppin *v.* Bond, 5 Ired. Eq. 91; Schroeppel *v.* Shaw, 3 N. Y. 446; Brick *v.* Freeholders etc. Co. 37 N. J. L. 307; Grover *v.* Hoppock, 26 Ib. 191; Morris Canal Co. *v.* Van Vorst, 21 Ib. 100; Hough *v.* Etna Life Ins. Co. 57 Ill. 318; Taylor *v.* Bank of Kentucky, 2 Marsh. 564; Reeves *v.* Pullian, 9 Baxt. 153; Pittsburgh etc. Ry. Co. *v.* Shaeffer, 59 Pa. St. 350; Allen *v.* Brown, 124 Mass. 77; Moreland *v.* State Bank, Breese, 203, 263. The creditor is under no obligation to the surety of active diligence to collect the debt of his principal. Glazier *v.* Douglass, 32 Conn. 400; Orme *v.* Young, 3 E. C. L. S. 84; Postmaster *v* Reeder, 4 Wash. 630; Black River Bank *v.* Page, 44 N. Y. 453; Wells *v.* Mann, 45 Ib. 327; Strong *v.* Worcester, 6 Vt. 536; Herrick *v.* Borst, 4 Hill, 656; Shroepfel *v.* Shaw, 3 N. Y. 454; in re Babcock, 3 Story, 393; Hayes *v.* Ward, 4 Johns. Ch. 132; Goodman *v.* Litaker, 84 N. C. 8.

[2] Paine *v.* Packard, 13 Johns. 174; King *v.* Baldwin, 17 Ib. 384; s c. 2 Johns. Ch. 554; Damick *v.* Hubbard, 27 Hun, 349; Reinsen *v.* Beekman, 25 N. Y. 552; Colgrove *v.* Tallman, 67 Ib. 95; Hunt *v.* Purdy, 82 Ib. 486; Church *v.* Simmons, 83 Ib. 264; Toles *v.* Adee, 81 Ib. 562; Peters *v.* Lincinschmidt, 58 Mo. 464; Cope *v.* Smith, 8 S. & R 110; Thomas *v.* Mann, 28 Pa. St. 520; Conrad *v.* Foy, 68 Ib. 381; King *v.* Haynes, 35 Ark. 463; Ward *v.* Stout, 32 Ill. 399; Bartlett *v.* Cunningham, 85 Ib. 22; Inning *v.* Fielder, 8 Bradw. 256; McCoy *v.* Lockwood, 71 Ind. 319; Smith *v.* Clayton, 48 Miss. 66; Caines *v.* Bates, 35 Mo. 427; Cole *v.*

creditor is required to press such suit against the principal debtor to final judgment and execution.[1] Under such statutes the notice is required to be in writing and served upon the creditor, or his representative, and must be full and explicit in its demand for the commencement of proceedings against the principal debtor. It should be so worded as that the creditor must know that unless he complies with such notice, his claims upon the surety will be discharged.[2]

§ 221. The recovery of Creditor, as against Surety.—The surety's liability in any action brought by the creditor against him in cases where a judgment upon such debt has been entered against the principal debtor, is the amount of such judgment. The sum stated in such judgment is conclusive as to the extent of liability of the surety. The proceedings by which such judgment against the principal are obtained must, however, be conducted in good faith, since the principal cannot enlarge the surety's liability, nor change his contract by any acknowledgement or admissions made at such time. If such proceedings are tainted with collusion or fraud, as between the creditor and principal, to the injury of the surety, equity relieves the surety from the operation of the rule stated, and allows him to show his real liability, irrespective of the judgment entered against the principal debtor.[3] The holder of prom-

Fox, 83 N. C. 463; Davis *v.* Snead, 32 Gratt. 705. See Hickox *v.* Farmers' Bank, 35 Vt. 476; Harris *v.* Newell, 42 Wis. 687.

[1] Peters *v.* Lincinschmidt, 58 Mo. 464.

[2] King *v.* Baldwin, 17 Johns. 384; s. c. 2 Johns.Ch. 554; Singer *v.* Trautman, 49 Barb. 182; Demick *v.* Hubbard, 27 Hun, 347; Mutual etc. Ins. Co. *v.* Davies, 56 How. 440; Maier *v.* Canavan, 57 Ib. 504; Russell *v.* Weintzer, 2 Abb. N. C. 422; Remsen *v.* Beekman, 25 N. Y. 552; Colgrove *v.* Tallman, 67 Ib 95; Hunt *v.* Purdy, 82 N. Y. 486; Bartlett *v.* Cunningham, 85 Ill. 22.

[3] United States *v* Allsbury. 4 Wall. 186; Lindsley *v.* Reid, 101 Pa. 357; Slee *v.* Bloom, 20 Johns 669; Stoops *v.* Wittler, 1 Mo. App. 420; Berger *v.* Williams, 4 McLean 125. Contra: Norton *v.* Abercrombie, 16 S. C; Hellams *v.* Abercrombie, 15 Ib. 110; ex parte Young, L. R. 17 Ch. D.665.

issory notes, however, can only collect from a surety thereon, what remains due on the notes after deducting the amount received from the principal debtor;[1] otherwise, as against the maker, since he will hold any surplus in trust for the indorser or surety.[2]

In an action upon a penal bond, recovery may be had against the principal and sureties, not only of the amount of the penalty named in the bond, but also interest upon such amount from the time of the breach.[3] Such interest is not considered as forming part of the penalty for the breach of the condition of the bond, but as damages for non-payment or detention of the penalty after it has become due and payable, namely, immediately upon breach of the condition. If the obligee then receives the amount thereof, he obtains the sum provided for by the contract; if he is paid at a later time, he secures less than what the contract provides. Immediately upon forfeiture of the penalty, it assumes the character of a debt due and payable.[4]

[1] In re Pulsifer, U. S. D. Ct. Ill. 14 Fed. Rep. 247.

[2] In re Pulsifer, supra; ex parte Talcott, 9 N. B. R. 502; in re Weeks, 13 Ib. 263; in re Ellerhorst, 5 Ib. 144; Downing *v.* Traders' Bank, 11 Ib. 371.

[3] Perit *v.* Dallis, 2 Dallas, 253; Branierd *v.* Jones, 18 N. Y. 35; Carter *v.* Carter, 4 Day, 30; Smedes *v.* Houghtaling, 3 Caines, 48; Clark *v.* Bush, 3 Cow. 151; Harris *v.* Clapp, 1 Mass. 307; Bank of Brighton *v.* Smith, 12 Allen, 243.

[4] Wyman *v.* Robinson, 73 Me. 584; United States *v.* Arnold, 1 Gall. 348 (Story, J.); Gainsforth *v.* Griffith, 1 Saund. 51, *n.* 1.

CHAPTER XXII.

THE SURETY'S COLLECTION OF COLLATERALS.

§222. The surety's enforcement of collaterals from principal.
223. Equitable aid to surety in such enforcement.
224. The surety's recovery upon principal's collateral promise.
225. The rule when security is for indemnity merely.
226. Surety's right of set-off against insolvent principal.
227. The surety's obligations as to collateral securities.
228. The surety's action at law against principal debtor.
229. Surety's right to lien of judgment as against principal.

§ 222. THE SURETY'S ENFORCEMENT OF COLLATERALS FROM PRINCIPAL.—The surety who has received securities from his principal under some new and independent agreement for indemnity and payment, as against the liability incurred by him upon the principal note, is entitled to enforce such collateral contract upon the maker's default, even before payment of the debt. The liability of the surety to pay the creditor must be fixed and certain, and the collateral contract of the principal with the surety must be to pay the debt, and not one of indemnification merely. The liability of the principal to pay the surety, where bound upon bond or covenant, is not affected at law by the equitable right of the principal that the money so paid shall be applied in payment of the debt. The obligation of the principal to the surety upon his independent contract arises upon default in payment of the principal debt, and is without limitation, and the securities given may be enforced without a prior payment of the debt.[1] A mortgage or deed

[1] Locke *v.* Homer, 131 Mass. 93; Smith *v.* Pond, 11 Gray, 234; Bettune *v.* Wallace, 2 Rich. 80; Stout *v.* Furnace *v.* Durgin, 119 Ib. 508;

of trust is a common form of security given by a principal debtor for the benefit of a surety and is equally available whether executed by the debtor himself, or is the mortgage of some third person held by the debtor, and by him assigned and delivered to the surety. Where a mortgage or deed of trust is conditioned to indemnify and to save a surety harmless, and to pay the debt upon maturity, the failure of the mortgagor and principal to pay constitutes a breach of the condition, and the surety is entitled to enforce the security in equity by foreclosure and sale. The contingent liability of the surety is a valuable and sufficient consideration to support the transfer or execution of such mortgage, and the foreclosure and sale of the property, and appropriation of the proceeds in satisfaction of his liabilities as surety. Nor is it material under such mortgage securities, that the surety shall have first paid the principal debt to entitle himself to the aid of equity.[1]

§ 223. Equitable aid to Surety in such enforcement.—Courts of equity afford relief to sureties upon collateral contracts and securities received by them from the principal debtor, upon the default of the latter to discharge

Folger, 34 Iowa, 71; Churchill *v.* Hunt, 3 Denio, 321; in re Negus, 7 Wend. 499; Port *v.* Jackson, 17 Johns. 239, 479, 482; Trinity Church *v.* Higgins, 48 N. Y. 532, Belloni *v.* Freeborn, 63 Ib 383; National Bank *v.* Bigler, 83 Ib. 51, 61; Lathrop *v.* Attwood, 21 Conn. 117; Redfield *v.* Haight, 27 Ib. 31; Gage *v.* Lewis, 68 Ill. 604; Hodgson *v.* Bell, 7 Term. R. 97; Holmes *v.* Rhodes, 1 B. & P. 638; Warwick *v.* Richardson, 10 M. & W. 284; Lethbridge *v.* Mytton, 2 B. & Ad. 772; Penny *v.* Foy, 8 B. & C. 11; s. c. 2 M. & Ry. 181. "The defendant may perhaps have an equity that the money he may pay shall be applied in discharge of his debt; but at law the plaintiff is entitled to be placed in the same situation under this agreement as if he had paid the money to the payee of the bill." Baron Parke, in Loosemore *v.* Radford, 9 M. & W. 657; Carr *v.* Roberts, 5 B. & Ad. 78; Smith *v.* Howell, 6 Exch. 930.

[1] Baven *v.* Haskins, 45 Miss. 186; Goodheart *v* Johnson, 88 Ill. 61, Moore *v.* Topliff, 107 Ib. 241, 249; Irick *v.* Black, 17 N. J. Eq. 189; Gibbs *v.* Maynard, 6 Paige's Ch. 258; Butler *v.* Ladue, 12 Mich. 180; Rockfeller *v.* Donnelly, 8 Cowen, 628; Norton *v.* Reid, 11 S. C. 593; Hellams *v.* Abercrombie, 15 Ib. 110.

the debt when due and payable. In order effectively to aid the surety to discharge himself from his liability, the creditor as well as the principal debtor may be made a party to the suit. The former, being present in court to receive payment, the whole litigation may thus be disposed of.[1] And where the principal debtor has deceased, his representatives may be brought into a court of equity with the creditor, and the same relief obtained.[2] Nor will a court of equity require a release by a surety of collateral securities received from the principal as a preliminary to proof of the debt against his estate.[3]

Where the condition of a mortgage is to save the mortgagee harmless from any loss by reason of his entering into a contract of suretyship, and to pay the debt upon maturity, the failure of the mortgagor and principal to pay is a breach of such condition. Nor will a power of sale contained in such mortgage, to arise only upon the damnification of the surety, affect the rights of the latter to foreclosure and sale upon a breach of the covenant, although the principal debt remains unpaid.[4] A bond or mortgage containing a promise to pay as well as an indemnity covenant, extends to a liability jointly incurred by the surety with the principal for money borrowed to pay the note for which such bond or mortgage was given as security, and by which such note was actually paid.[5]

§ 224. THE SURETY'S RECOVERY UPON PRINCIPAL'S COLLATERAL PROMISE.—The surety's right of recovery of the whole amount of his liability upon the principal obligation, before payment thereof, by the collection of col-

[1] Gibbs *v.* Menard, 6 Paige's Ch. 258; Irick *v.* Black, 17 N. J. Eq. 189; Hellams *v.* Abercrombie, 15 Ib. 110, Baven *v.* Haskins, 45 Miss. 186; Moore *v.* Topliff, supra.

[2] Woodbridge *v.* Norris, L. R. 6 Eq. 410.

[3] West *v.* Bank of Rutland, 19 Vt. 403.

[4] Butler *v.* Ladue, 12 Mich. 180; Rockfeller *v.* Donnelly, 8 Cowen, 628.

[5] Nesbit *v.* Worts, 37 Ohio St. 378.

lateral securities received from the principal under contracts of indemnification and to pay the debt,[1] is supported in cases where bonds with covenants to save the makers of negotiable promissory notes payable to third persons harmless and indemnifying them therefrom and to pay the notes, are given.[2] Upon the execution of a joint note, both parties appearing as principals, but one being a surety, the principal debtor gave a bond to the surety covenanting to pay the amount of the note to the payee thereof at maturity. Upon default, a recovery was permitted the surety upon the bond to the whole face value of the note, although no payments had been made thereon by him.[3] The rule is applied where the person standing in the relation of surety gives his own notes payable in the future in payment of the debt. A bond given by one partner upon the dissolution of the firm covenanted to indemnify and save harmless the retiring partner, and "to pay and satisfy" the debts of the partnership. Default occurring in such covenant, the retiring partner was allowed to recover upon the bond damages to the amount of outstanding indebtedness, although notes had been given for it.[4]

[1] Wicker *v.* Hoppock, 6 Wall. 94; Lathrop *v.* Attwood, 21 Conn. 117; Redfield *v.* Haight, 27 Ib. 31; Gage *v.* Lewis, 68 Ill. 604; Stout *v.* Folger, 34 Iowa, 71; Locke *v.* Homer, 131 Mass 93; Furnace *v.* Durgin, 119 Ib. 508; Smith *v.* Pond, 11 Gray, 234; Churchill *v.* Hunt, 3 Denio, 321; in re Negus, 7 Wend. 799; Port *v.* Jackson, 17 Johns. 239, 479; Trinity Church *v.* Higgins, 48 N. Y. 532; Belloni *v.* Freeborn, 63 Ib 383; Bethune *v.* Wallace, 2 Rich. 80; Loosemore *v.* Radford, 9 M. & W. 657; Warwick *v.* Richardson, 10 Ib. 284; Lethbridge *v.* Mytton, 2 B. & Ad. 772; Carr *v.* Roberts, 5 B. & Ad. 78; Smith *v.* Howell, 6 Exch. 730; 1 Saund. 116, *n.*

[2] Churchill *v.* Hunt, 3 Den. 321; Trinity Church *v.* Higgins, 48 N. Y. 532; Belloni *v.* Freeborn, 63 Ib. 383; Hart *v.* Folger, 34 Iowa, 71; Smith *v.* Pond, 11 Gray, 234.

[3] Loosemore *v.* Radford, 9 M. & W. 657.

[4] Lathrop *v.* Atwood, 21 Conn. 117; Redfield *v.* Haight, 27 Ib. 31; Gage *v.* Lewis, 68 Ill. 604; In re Negus, 7 Wend. 499; Locke *v.* Homer, 131 Mass. 93; Robinson *v.* Robinson, 24 L. T. Rep 112; Loosemore *v.* Radford, 9 M. & W. 657, Lethbridge *v.* Mytton, 2 B. & Ad. 772.

The enforcement of collateral securities, without payment of the debt, was allowed where an indemnity bond to save harmless and to pay the money was given upon a misappropriation of trust funds by one of two trustees to the other. The trustee, or his representatives, recovered from the fraudulent trustee the amount of the bond.[1] The recovery of the probable loss of a surety was permitted without any payment having been made, where a mortgage was given as security against loss by reason of indorsement of notes for the mortgagor, the stipulation in the mortgage security being that the mortgagors should "pay the sum of money above secured."[2] A third person holding securities of the principal in trust for the benefit of a surety, is required in equity to apply the proceeds of the same in payment of the debt, upon default of the principal, although the surety has not actually been damnified.[3]

§ 225. The rule where Security is for Indemnity merely.—A surety who receives from the principal debtor, upon entering into the contract of suretyship, or subsequently, collateral securities as against his liability on the principal obligation, the condition of such securities being to indemnify and save him harmless but with no affirmative promise to pay, is not entitled to relief by the enforcement of such securities until damnified. Under this rule, payment of the debt is generally required before a court of equity will aid the surety in rendering the mortgage or other security available for his indemnification. Until the surety has discharged his personal obligation upon the principal note, the debtor having failed to pay the same, he has suffered no loss. Where proceedings, however, have been taken against the surety so that in order to save his own property from execution and sale, resort must be had to the

[1] Warwick *v.* Richardson, 10 M. & W. 284.

[2] Gunel *v.* McCue, 72 Ind. 34; Wright *v.* Whiting, 40 Barb. 235.

[3] Daniel *v.* Joyner, 3 Ired. Ch. 513.

securities held from the principal debtor, the equity of the surety is preferred. In such cases, the property of the principal debtor thus pledged for the indemnification of the surety is first exhausted, if it can be done without injury or loss or delay to the creditor.[1] Nor will a court of equity give relief to a surety seeking to enforce payment from the principal upon securities given by him, where there is another equity of equal weight which would suffer by such enforcement.[2] Nor will relief be given in the case of a surety in a bond to the government, where a breach of the condition operates as a forfeiture of the whole penalty of the bond, as a court of equity will not lend its aid to enforce a forfeiture or penalty against the principal until the surety has become absolutely fixed with the payment of such penalty by the recovery of judgment against him.[3]

§ 226. A SURETY'S RIGHT OF SET-OFF AGANST INSOLVENT PRINCIPAL.—An insolvent principal is not allowed to enforce the collection of a debt which is owing to him by a surety without first indemnifying the latter upon his obligations. A surety has, as against his principal, the rights of a creditor; and upon the insolvency of the principal, may retain any funds or securities in his possession belonging to his principal by way of indemnity against his liability.[4] A court of equity will upon application by a surety, restrain a principal from proceeding at law to enforce the collection of a debt owing by such surety, where the latter is obligated for the principal by his contract to an amount

[1] National Bank *v.* Bigler, 83 N. Y. 53, 61; Trinity Church *v.* Higgins, 48 N. Y. 537; Shaw *v.* Loud, 12 Mass. 449; Gilman *v.* Moody, 43 N. H. 243; Post *v* Tradesmen's Bank, 28 Conn. 420; Shepard *v.* Shepard, 6 Ib. 37; McLean *v.* Ragsdale, 31 Miss. 701; Butler *v.* Ladue, 12 Mich. 180; Powell *v.* Smith, 8 Johns 249; Rockfellow *v.* Donnelly, 8 Cow. 628.

[2] Loosemore *v.* Radford, 9 M. & W. 657; Lethbridge *v.* Mytton, 2 B. & Ad. 772.

[3] Gibbs *v.* Menard, 6 Paige's Ch. 258.

[4] Mattingly *v.* Sutton, 19 W. Va. 19.

in excess of the debt, unless upon full indemnification.[1] The insolvency of one of the parties is sufficient to give jurisdiction to enforce an equitable set-off, which is allowed, although the debt of the principal to the surety be not due.[2] A surety indebted to his principal may, upon equitable grounds, require him to pay the debt as soon as it matures, and may file a bill to compel the appropriation of the amount he owes the principal to discharge his obligation to the creditor.[3] A payment by a surety to the creditor may be set off in an action by the principal against such surety, although not made until after suit brought.[4] An assignee of a judgment obtained by a principal against a surety in the cases mentioned, stands in no better position than his assignor.[5]

§ 227. The Surety's obligations as to Collateral Securities.—A surety who has received collateral securities from his principal to protect him in the obligations incurred, is required, upon the discharge of the debt by the principal to return the same to the pledgor. Mere technical objections are not allowed to be set up as a ground upon which to refuse to make such re-transfer.[6] The return of such securities, however, cannot be demanded until the contract obligations of the surety upon the principal debt have been satisfied, and the surety fully released.[7] Only fraud or gross negligence sufficient to create a presumption of fraud, will charge sureties who have received collateral securities from their principals with their loss. Such charge is only made where it would be unjust and inequitable to the principal were the sureties not so charged.[8]

[1] Abbey *v.* Van Empen, 1 Freem. Ch. 273.

[2] Lindsay *v.* Jackson, 2 Paige, 581; Simpson *v.* Hart, 14 Johns, 63; Mattingly *v.* Sutton, 19 W. Va. 19.

[3] Mattingly *v.* Sutton, supra.

[4] Thompson *v.* McClelland, 29 Pa. St. 475; Beaver *v.* same, 23 Ib. 166; Brittain *v.* Quitt, 1 Jones Eq. 328.

[5] Mattingly *v.* Sutton, 19 W. Va. 19.

[6] Blackford *v.* Brown, 34 Mich. 4.

[7] Jewett *v.* Warren, 12 Mass. 300; Vest *v.* Green, 3 Mo. 219.

[8] Wells *v.* Wells, 53 Vt. 1.

In the absence of a special agreement between the principal debtor and surety, the mere receipt by the latter of collateral security in fulfilment of a promise of indemnification, whether express or implied, is not sufficient of itself to discharge the principal from his obligation to the surety to pay the debt at maturity.[1] Where such security proves worthless, a surety may, upon the equitable terms of payment of the debt, proceed at once to an action at law to recover the amount thus paid.[2] But a surety holding collateral security from his principal who has neglected to avail himself of the proceeds thereof to pay the debt, and has suffered his own property to be sold at a great sacrifice, upon an execution issued upon the principal debt, is not entitled to maintain an action against the principal for his special damage.[3]

§ 228. The Surety's action at law against Principal debtor.—No recovery at law as against his principal is permitted the surety until he has himself first paid the debt or judgment rendered thereon, unless by an express agreement giving a right of action to the surety before payment.[4] The surety's right of action at law as against his principal accrues at the time of payment of the principal debt, from which time the statute of limitations begins to run.[5] Nor will any thing less than a payment and satisfaction of the whole amount of the principal debt be sufficient, as a surety is not allowed to sue his principal as often as he chooses to pay a portion of the debt which, upon the prin-

[1] Cornwall *v.* Gould, 4 Pick. 444.

[2] Coburn *v.* Parker, 11 Gray. 335.

[3] Vance & Lancaster, 3 Hay (Tenn.) 130.

[4] Morgan *v.* Smith, 70 N. Y. 537; Powell *v.* Smith, 8 Johns. 249; Elwood *v.* Diefendorf, 5 Barb. 398; Trotter *v.* Strong, 63 Ill. 272; Darst *v.* Bates, 51 Ib. 439; Benham *v.* Galloway, 13 Ib. 68; Shepard *v.* Ogden, 2 Scam. 257; Leabo *v.* Goode, 67 Mo. 126; Hearne *v.* Keath, 63 Ib. 84. Hellams *v.* Abercrombie, 15 S. C. 110; Peters *v.* Barnhill, 1 Hill, 234; Stinson *v.* Brennan, Chev. 16. Peacock *v.* Jeffrey, 1 Taunt. 426.

[5] Loughbridge *v.* Bowland, 52 Miss. 546; Bonham *v.* Galloway, 13 Ill. 68; Shepard *v.* Ogden, 2 Scam. 257.

cipal's default, he is bound to pay in full.[1] Where a judgment is entered against himself and the principal, and the surety has paid the same, he may sue the principal at law, although entitled to an execution upon the judgment on the principal note.[2] No rights are acquired by payments made by a surety under a mistaken belief that he was liable, nor will they be sufficient to support an action at law against the principal debtor,[3] nor where such surety has given his own promissory notes, on time, unless he shows that they have been paid, or that he has means to pay them at maturity.[4] The rule is the same where the payment of such new notes are secured by mortgage, unless the creditor has received the same in full satisfaction of his claim against the principal debtor.[5] The surety's recovery is generally restricted to the amount he has actually paid to discharge the debt and costs.[6] No action, however, can be maintained to enforce an indemnity against a liability which has not arisen, and which may never exist.[7]

It is a good defense to an action at law by a surety for money paid to his principal's use, that the defendant offers to show that he has assigned, in pursuance of an agreement with plaintiff and other sureties, the whole of his property in consideration of being exonerated from all liabilities, and to be subject to no further claims growing out of such contract of suretyship. An agreement to this effect constitutes a good accord and satisfaction, and is supported as a compromise, executed, and with evidence to sustain it.[8] A

[1] Jones *v.* Trimble, 3 Rawle, 381.

[2] Kimmel *v.* Lowe, 28 Minn. 265; Lange *v.* Perley, 47 Mich. 352.

[3] Bancroft *v.* Abbott, 3 Allen, 524.

[4] Lynch *v.* Hancock, 14 S. C. 66.

[5] Witherby *v.* Mann, 11 Johns. 518; Bormey *v.* Seeley, 2 Wend. 481.

[6] Hearne *v.* Keath, 63 Mo. 84; Eggeshall *v.* Ruggles, 62 Ill. 401; Bormey *v.* Seeley, 2 Wend. 481; Morgan *v.* Smith, 70 N. Y. 537.

[7] Hughes *v.* Indian Mines Co., L. R. 20 Ch. D. 561; Lloyd *v.* Dimmack, L. R. 7 Ib. 398. Otherwise, as to an existing liability. Phene *v.* Gillian, 5 Hare, 1, 12.

[8] Lange *v.* Perley, 47 Mich. 352; Pulliam *v.* Taylor, 50 Miss. 251; Bull *v.* Bull, 43 Conn. 455; Marvin *v.* Treat,

judgment was obtained against a principal debtor and sureties on a note, and the recovery being less then expected, the creditor obtained an indictment of perjury against the principal. Subsequently the felony was compounded by the transfer to him of a note of a third person, being the whole property of the debtor. The surety's liability on the judgment remaining unaffected, a court of equity required the proceeds of the note to be appropriated to the payment of the judgment, the surety being without part in the illegal transaction.[1]

§ 229. Surety's right to lien of judgment as against Principal.—A surety who has paid a judgment entered against him by a creditor upon his obligation for his principal, is entitled to be subrogated for his indemnity to the lien of the judgment upon his principal's land. The rule was applied where separate judgments had been entered at different terms of a court, one against the principal, and the other against the surety, and subsequently a further judgment was entered in another state upon the record of the judgment rendered against the surety. This last judgment was paid by the surety, who was allowed subrogation to the judgment lien of the creditor as against the land of the principal on the first judgment.[2] A surety was allowed where several judgments had been obtained against both principal and surety for the same debt, and the latter had paid the judgment against himself, whereupon the sheriff

37 Conn. 96; Blinn *v.* Chester, 5 Day, 359; Eaton *v.* Lincoln, 13 Mass. 424; Peck *v.* Davis, 19 Pick. 490; Brooks *v.* White, 2 Met. 283; Tuttle *v.* same, 12 Ib. 551; Donohoe *v.* Woodbury, 6 Cush. 149; Bigelow *v.* Baldwin, 1 Gray, 245; Ball *v.* Wyett, 99 Mass. 338; Guild *v.* Butler, 127 Ib. 386; Savage *v.* Everman, 70 Pa. St. 315; McCreary *v.* same, 5 Gill. & J. 147; Mellen *v.* Goldsmith, 47 Wis. 573; Waysdall *v.* Duer, 3 Den. 410; La Farge *v.* Herter, 11 Barb. 171; Watkins *v.* Inglesby, 5 Johns. 386; Renard *v.* Fuller, 4 Bosw. 107; Ludington *v.* Bell, 77 N. Y. 138; Boyd *v.* Hind, 1 H. & N. 947; Good *v.* Cheesman, 2 B. & Ald. 328; Mellen *v.* Goldsmith, 29 E. L. & E. 241.

[1] Breese *v.* Schuler, 48 Ill. 429.

[2] Bank *v.* Allen, 76 Va. 200.

entered satisfaction on both executions, to vacate such satisfaction of the judgment against his principal, and to enforce it against his estate.[1] Generally judgments rendered in one state upon judgments previously rendered in another state, merge the first judgment, so that a surety has no right upon payment to be subrogated to the first judgment as it is extinguished.[2]

[1] Perkins *v.* Kershaw, 1 Hill's Ch. (S. C.) 344.

[2] Gould *v.* Hayden, 63 Ind. 443; Cook *v.* Armstrong. 25 Miss. 63; Purdy *v.* Doyle, 1 Paige, 558; Chitty *v.* Glenn, 3 Monr. 424; Whiting *v.* Beebe, 7 Eng. (Ark.) 549; Frazier *v.* McQueen, 20 Ib. 68; Hannah *v.* Guy, 3 Bush, 91; Denegre *v.* Ham, 13 Iowa, 240; Bank of U. S. *v.* Patton, 5 How. 200.

CHAPTER XXIII.

CONTRIBUTION BY SURETIES WITH COLLATERALS.

§230. Contribution as to collateral securities by co-sureties.
231. Surety with collaterals a trustee for co sureties.
232. Holding collaterals, no bar to suit for contribution.
233. The surety's right to collateral securities of co-sureties.
234. Limitation and waiver of right of contribution.
235. Application of proceeds of co surety's securities.
236. The right of contribution where part only of debt paid.
237. Contribution between accessory sureties.
238. The surety's action at law for contribution.

§ 230. Contribution as to Collateral Securities by Co-Sureties.— Contribution between co-sureties is founded upon the maxim "Equality is equity," and rests upon natural justice. Persons holding the relations of co-sureties stand upon a common ground of interest and right, and are entitled to contribution as well in the application of collateral securities given by the principal debtor to one or more of such co-sureties, as to contribution from them in payment of the principal debt. The claim of sureties to the benefit of collateral securities held by a co-surety is founded upon principles of equity governing the relations of co-sureties to one another. The right is given independently of any contract, or of the intentions of the principal debtor giving and surety receiving such securities; for the right to contribution from the co-surety holding such collaterals is equally as strong where they are given for the special benefit of such co-surety as where given generally. The principal debtor is not permitted, while the principal obligation remains unpaid, and the liabilities of sureties to each other unsettled, to cast a greater burden upon one or more sureties

by securing the others, when all at the inception of the undertaking stood upon an equal footing. The securities the principal puts in the power of one surety for his own relief constitute a quasi trust fund for the indemnity of all his co-sureties.[1]

§ 231. Surety with Collaterals a trustee for Co-sureties.—One of two or more co-sureties who holds collateral securities from the principal debtor to indemnify him in his obligations as surety, is chargeable with a quasi or secondary trust concerning the same for the benefit of the co-sureties. In connection therewith he is required to act in good faith; and if, by fraudulent dealings or gross negligence amounting to fraud, such securities are lost or rendered valueless, it is a good defense *pro tanto* against any suit for contribution by such surety.[2] A surety may by

[1] Logan *v.* Talcott, 59 Cal. 652; Scribner *v.* Adams, 73 Me. 541; Steele *v.* Mealing, 24 Ala. 285; Taylor *v.* Morrison, 26 Ib. 728; Monson *v.* Drakely, 40 Conn. 552; Robertson *v.* Detherage, 82 Ill. 511; Paul *v.* Berry, 78 Ib. 158; Salyers *v.* Ross, 15 Ind. 130; Siebert *v* Thompson, 8 Kan. 65; Batchelder *v.* Fisk, 15 Mass. 464; Chaffee *v.* Jones, 19 Pick. 260; Hood *v.* Leland, 1 Met. 387; McCune *v.* Belt, 45 Mo. 174; State *v.* Berning, 74 Ib. 98; Nally *v.* Long, 56 Md. 567; Smith *v.* Conrad, 15 La. Ann. 594; Brown *v.* Ray, 18 N. H. 102; Paulin *v.* Kaighn, 27 N. J. L. 503; s. c. 29 Ib. 480; Hall *v.* Robinson, 8 Ired. L. 56; Bell *v.* Jasper, 2 Ired. Ch. 597; Leury *v.* Cheshire, 3 Jones Eq. 170; Campbell *v.* Mesier, 4 Johns. Ch. 334; Elwood *v.* Diefendorf, 5 Barb. 398; Norton *v.* Cooms, 6 N. Y. 33; Wells *v.* Miller, 66 Ib. 255; Armitage *v.* Pulliver, 37 Ib. 494; Sayles *v.* Sims, 73 Ib. 551; Hinckley *v.* Kreitz, 58 Ib. 543; Butler *v.* Birkey, 13 Ohio St. 514; McCrory *v.* Parks, 18 Ib. 1; Agnew *v.* Bell, 4 Watts, 31; McMahon *v.* Fawcett, 2 Rand. 514; Mitchell *v.* Bass, 24 Tex. 392; Miller *v.* Sawyer, 30 Vt. 412; Aldrich *v.* Hopgood, 39 Ib. 617; Mayhew *v.* Crickett, 2 Swanst. 198; Craythorne *v.* Swinburne, 14 Ves. 160; Swain *v.* Wall, 1 Rep. Ch. 149; Knight *v.* Hughes, Mood. & M. 247; Deering *v.* Winchelsea, 2 B. & P. 270; Steel *v.* Dixon, L. R. 17 Ch. D. 825.

[2] Green *v.* Millbank, 56 How. 382; Fielding *v* Waterhouse, 40 N. Y. Supr. Ct. 414; Paulin *v.* Kaighn, 29 N. J. L. 480; Schmidt *v.* Coulter, 6 Minn. 492; Taylor *v.* Morrison, 26 Ala. 728; Roberts *v.* Sayer, 6 Monr. 188; Ramsey *v.* Lewis, 30 Barb. 403; Morrison *v.* Poyntz, 7 Dana, 307. Where he sells the securities, and fails to collect the proceeds. Chilton *v.* Chapman, 13 Mo. 470. Taylor *v.* Morrison, 26 Ala. 728; Hall *v.* Robinson, 8 Ired. 56; Cheeseborough *v.* Millard, 1 Johns. Ch. 409.

his default in this respect estop himself from asserting an equitable right to contribution which otherwise he might have as against co-sureties.[1] The release or surrender by a surety of a mortgage or other security given by the principal debtor to one of two or more sureties without the consent of other co-sureties, operates as a waiver of the right to contribution to the extent at least of the value of the securities so released or surrendered.[2] An agreement by a principal debtor under which he has deposited funds with a person who has signed notes with him as surety, that the same shall be applied to the payment thereof, cannot be revoked after the negotiation of such notes for value. Upon a failure of the surety to apply the money as agreed co-securities are discharged of any claim to contribution.[3] Such surrendered securities are estimated at their face value, unless shown to be of less value.[4]

§ 232. Holding Collaterals, no bar to suit for Contribution.—The claim of the surety to contribution from his co-sureties is not defeated by his mere receipt of collateral securities from the principal. Upon payment of his aliquot portion of the debt by a co-surety, the latter is entitled to contribution from the securities held by his co-surety.[5] This relief, however, is granted only upon equitable terms. A surety obtaining indemnity for a valuable consideration paid, is not required to extend the benefits arising therefrom to a co-surety, without the latter first pays his proportion of the consideration. If an offer of security be made by the principal debtor upon condition that the sureties shall execute a release, and one surety only accepts, the other refusing, although the latter may require

[1] Steel *v.* Dixon, L. R. 17 Ch. D. 832.

[2] Goodloe *v.* Clay, 6 B. Mon. 236; Ramsey *v.* Lewis, 30 Barb. 403; Taylor *v.* Morrison, 26 Ala. 728; Paulin *v.* Kaighn, 29 N. J. L. 480.

[3] Morrison *v.* Taylor, 21 Ala. 779; Mandigo *v.* same, 26 Mich. 349.

[4] Paulin *v.* Kaighn, supra.

[5] Paulin *v.* Kaighn, 29 N. J. L. 480; Johnson's Admr. *v.* Vaughan, 65 Ill. 425.

that the proceeds of the securities shall be applied in reduction of the common debt, such proceeds can in no other way enure to his benefit. Payment of the debt would discharge the former surety from contribution if it amounted to his proportion of the common liability.[1] Co-sureties are not discharged by a mere exchange of securities by a surety receiving the same from the principal debtor if made in good faith, although without the knowledge of co-sureties.[2]

Where, however, the securities given to one of two or more sureties by the principal debtor are of sufficient value to reimburse the surety holding the same upon payment of the debt, equity requires him to enforce such securities rather than to bring an action or suit for contribution against his co-sureties.[3] Where such securities upon realization prove to be less in value than the debt, the surety paying the debt, is entitled to contribution as to the excess paid.[4]

§ 233. The Surety's right to Collateral Securities of Co-sureties.—As affecting the rights of co-sureties to contribution, it is immaterial whether the collateral securities held by a surety from the principal debtor are received in virtue of a bargain made at the time of the entry into the relations of suretyship or are given subsequently. The rule is that whatever goes to diminish the total burden of such sureties must be brought as between the co-sureties into "hotch-pot."[5] Nor is the claim to contribution affected by the fact that the co-sureties, upon entering into the contract, were uninformed of the agree-

[1] White *v.* Banks, 21 Ala. 705.

[2] Carpenter *v.* Kelly, 9 Ohio, 106.

[3] Morrison *v.* Taylor, 21 Ala. 779.

[4] Currier *v.* Fellows, 27 N. H. 366; Batcheldor *v.* Fisk, 17 Mass. 464; John *v.* Jones, 16 Ala. 454.

[5] Norton *v.* Cooper, 6 N. Y. 33; Agnew *v.* Ball. 4 Whart. 31; Moor *v.* Bray, 10 Pa. St. 519; Hall *v.* Robinson, 8 Ired. 56; Miller *v.* Sawyer, 30 Vt. 412; McCune *v.* Belt, 45 Mo. 174; Whipple *v.* Briggs, 28 Vt. 617; Fuller *v.* Hapgood, 39 Ib. 617; Dearing *v.* Winchelsea, 1 Cox, 318; Steel *v.* Dixon, L. R. 17 Ch. D. 832.

ment between the principal and surety for the giving of such securities.[1] Sureties, to be entitled to contribution, must not only be bound as co-sureties, but there must be the same relation to the common principal and an absence of equities as between themselves. The actual relations of the parties may be shown by parol.[2] Nor will contribution exist as against a co-surety, by reason of any consideration existing between the principal debtor and the co-surety after the entry of the latter into his original contract of suretyship, especially where the rights of third parties would be affected.[3]

The rule that the surety is entitled upon payment of the debt to collateral securities held by the co-surety, is enforced where the security is an absolute bill of sale of certain property, parol proof being admitted to show that it was given only as security.[4] The equitable principle of contribution was not applied where a surety of a defendant in execution having paid the amount of the judgment and obtained an assignment thereof, by a summary proceeding at law sought to sue out an execution against his co-surety. Such a proceeding being a purely legal one, conducted in a summary manner, without the formalities of pleading, rendered it impossible to invoke equitable doctrines in favor of the surety.[5]

§ 234. Limitation and waiver of the right of Contribution.—A surety, before becoming such, may fairly stipulate with the principal debtor for a separate indem-

[1] Wells *v.* Miller, 66 N. Y. 255; Norton *v.* Cooms, 6 Ib. 133; Barry *v.* Ransom, 12 Ib. 462; Campbell *v.* Mesier, 4 Johns. Ch. 337; Craythorne *v.* Swinburne, 14 Ves. 640; Steel *v.* Dixon, L. R. 17 Ch. D. 825.

[2] Sayles *v.* Sims, 73 N. Y. 551, Hinckley *v.* Kreitz, 58 Ib. 583; Wells *v.* Miller, supra.

[3] Hines *v.* Keller, 3 W. & S. 401.

[4] Gregory *v.* Murrell, 2 Ired. Eq. 233; Hall *v.* Hoxsey, 84 Ill. 616.

[5] Hull *v.* Sherwood. 59 Mo. 172; Hammond *v.* Wyman, 9 Mass. 138; Brackett *v.* Winslow, 17 Ib. 154; Stevens *v.* Moore, 7 Greenl. 24; Adams *v.* Drake, 11 Cush. 503; Spiegelmeyer *v.* Crawford, 6 Paige, 254; Clason *v.* Morris, 10 Johns. 524; Harbeck *v.* Vanderbilt, 20 N. Y. 395.

nity for himself. If he does so, his co-sureties are entitled to the surplus only after his full exoneration.[1] And as between themselves, co-sureties may by agreement so far sever their unity of interest and obligation as to waive or abandon their claim to contribution.[2] A surety loses his right of contribution where, by a previous agreement with the principal, made without the knowledge of the co-surety, he received a part of the money obtained on the negotiation of the paper, although he had paid the whole debt.[3] A surety receiving securities for individual claims against the principal debtor, will not be subjected to contribution by co-sureties upon another and independent debt.[4] Sureties may contract themselves out of any benefit to which they would be entitled from collateral securities held by co-sureties.[5] The securities so received or the proceeds thereof when appropriated to a particular debt, can not be applied by the surety to the payment of any other debt of the principal, to the injury or prejudice of the co-sureties.[6] Equity will follow such securities into the hands of a co-surety or of a third person, where it can be done without injury.[7]

§ 235. Application of proceeds of Co-surety's Securities.—Collateral securities, or the proceeds thereof, held generally by one who is a surety on different obligations, with different co-sureties on each, are applied pro rata to the several claims, and for the benefit of such co-sureties.[8] Where securities are given by the principal debtor to one who is sole surety in one case and joint surety in others, as a general indemnity for the surety's liabilities, the application of the proceeds of such securities is governed by the maturity of the obligations the payment of which

[1] New Bedford Savings Inst *v.* Fairhaven Bank, 9 Allen, 175; Scribner *v.* Adams, 73 Me. 541.

[2] Paul *v.* Berry, 78 Ill. 158.

[3] McPherson *v.* Talbott, 5 Gill & J. 499.

[4] McCune *v.* Belt, 45 Mo. 174.

[5] Steel *v.* Dixon, L. R. 17 Ch. D. 825.

[6] Steele *v.* Mealing, 24 Ala. 285.

[7] Whipple *v.* Briggs, 30 Vt. 111.

[8] Brown *v.* Ray, 18 N. H. 102.

they are given to secure, irrespective of the fact whether they bear the name of the surety only or of co-sureties in addition thereto.[1] A surety who is also a creditor may apply securities first to the payment of his own debt as against the right of contribution of co-sureties on other obligations.[2]

§ 236. The right of Contribution where part only of Debt paid.—The equitable right of contribution among co-sureties arises also in cases where a surety has paid more than his share of the principal debt. In such case the paying surety is entitled to recover of his co-sureties the amount paid in excess of his proportion of the debt. This equity, however, arises only where the surety has paid such an amount of the debt as to make it clear that, as between himself and his co-sureties, he has paid all he ever can be required to pay. When this is ascertained the surety is entitled to proceed for contribution against the co-sureties for the excess paid.[3] Sureties paying but a portion only of the liability for which they are bound, are not admitted as against the creditor remaining unpaid as to the remaining part of the debt, in an action of contribution against co-sureties, to the benefit of collateral securities deposited by the debtor with such co-sureties. The equitable right of the creditor is preferred, for until his debt is fully paid, sureties who have paid only a part of the debt, are not entitled to any equitable claim upon such collaterals for reimbursement.[4] The bar of the statute of limitations runs, in an action for contribution, only from the time the surety pays in excess of his pro rata liability.[5]

[1] Whipple *v.* Briggs, 30 Vt. 111.

[2] Brown *v.* Ray, 18 N. H. 102.

[3] Morgan *v.* Smith, 70 N. Y. 537; Backus *v.* Coyne, 45 Mich. 584; ex parte Gifford, 6 Ves. 805; Davis *v.* Humphreys, 6 M. & W. 153; Lawson *v.* Wright, 1 Cox, 275; ex parte Snowden, L. R. 17 Ch. D. 44.

[4] Kelly *v.* Herrick, 131 Mass. 373.

[5] Magruder *v.* Admire, 4 Mo. App. 133; Lytle *v.* Pope, 11 B. Monr. 297; Davis *v.* Humphreys, 6 M. & W. 153.

§ 237. Contribution between accessory Sureties. —Where two bonds with sureties are given for the performance of the same duty, and different parties are sureties thereon, any one of such sureties, on paying the debt, is entitled, in equity and at law, to contribution from the co-sureties on both bonds.[1] A surety, who has been compelled to pay the amount of a judgment against the principal debtor, may compel contribution from sureties on a second bond for the same principal, which has been executed as security for the same obligation.[2] Where a second bond was executed by a guardian, a surety upon the first, who had paid a deficiency of his principal, was allowed to enforce the rights of the ward as to the second bond so far as to compel contribution from sureties thereon.[3] In an action by A against B an attachment on B's property was dissolved upon a bond with C and D as sureties. A recovered judgment against B, which not being paid, suit was brought upon the bond, and judgment was recovered against B, C and D, and B was arrested on execution. B took the oath as a poor debtor, and entered into recognizances, with E as surety. After breach thereof, C and D paid the judgment, and brought suit in the name of A against E. As payment of a judgment by one of several joint debtors extinguishes it as to all, the claim for contribution was not allowed.[4]

A surety is entitled to contribution and to subrogation as against an accessory surety, where the latter enters into the obligation for the purpose of gaining time or other favor for the principal debtor, but in such a manner that the obligation of the first surety is not discharged.[5] Such subrogation

[1] Decring *v.* Winchelsea, 2 B. & P. 270; Craythorne *v.* Swinburne, 14 Ves. 160; Mayhew *v.* Crickett, 2 Swanst. 184; Emicks *v.* Powell, 2 Strobh. Eq. 196; Chaffee *v.* Jones, 19 Pick. 260; Norton *v.* Cooms, 3 Denio, 130.

[2] Bosley *v.* Taylor, 5 Dana, 157.

[3] Commonwealth *v.* Cox, 36 Pa. St. 442.

[4] Holmes *v.* Day, 108 Mass. 563; Kammatt *v.* Wyman, 9 Ib. 138; Brackett *v.* Winslow, 17 Ib. 153, Adams *v.* Drake, 11 Cush. 504.

[5] Schnitzel's App. 49 Pa. St. 23; Potts *v.* Nathans, 1 W. & S. 155;

and contribution, however, does not follow in cases where the accession of a surety is made so that the further liability of the first surety is extinguished.[1] But where two judgments having been obtained in part against the same person upon the same liability, the last being upon an appeal bond, and the sureties bound thereon paid the last judgment, they were given the rights of the holders of the first judgment, notwithstanding an entry of satisfaction had been made on the record, as against a purchaser of the land subject thereto, who was not a purchaser for value, without notice, in the usual course of business.[2]

§ 238. THE SURETY'S ACTION AT LAW FOR CONTRIBUTION.—The right to an action at law of one of two or more co-sureties for contribution is dependent upon the fact that the surety has paid the judgment or debt. Before payment one co-surety has no right of action against another. Up to such payment the co-sureties stand to each other upon a perfect equality.[3] The recovery of a surety who has paid the whole debt from a co-surety in an action at law for contribution, is limited, unless otherwise provided by statute, to an aliquot part of the whole debt, regard being had to the number of sureties, irrespective of their solvency. If any of the co-sureties are insolvent, equity will aid the paying surety to recover a larger proportion from the

Burns *v.* Huntington Bank, 1 P. & W. 395.

[1] Webster's App. 86 Pa. St. 409.

[2] Burgett *v.* Patton, 99 Ill. 288, 302; Poe *v.* Darrah, 20 Ala. 238; Stiles *v.* Eastman, 1 Kelley (Ga.) 205; Wilson *v.* Wright, 7 Rich. 401; Lintz *v.* Thompson, 1 Head, 456; Smith *v.* Alexander, 4 Sneed, 482.

[3] Kelly *v.* Herrick, 131 Mass. 373; Ohio Life Ins. Co. *v.* Ledyard, 8 Ala. 866; Ten Eyck *v.* Holmes, 3 Sandf. Ch. 428; Wilcox *v.* Fairhaven Bank, 7 Allen, 270; Clark *v.* Ely, 2 Sandf. 166; Reeves *v.* Pullian, 9 Baxter, 153. Such payments may be made in property, money, negotiable paper or securities, and where it is received in full satisfaction, the right of contribution arises. Ralston *v.* Davis, 15 Ill. 159. Davis *v.* Emerson, 17 Me. 64; Bachelder *v.* Fiske, 17 Mass. 464.

solvent sureties, that the burden may be borne equally.[1] Where, after the debt has been discharged by the sureties, money is paid by the principal to one surety in order to reimburse both, the co-surety, upon default, may bring his action at law against the surety receiving the money as for money had and received. Equity courts will not take jurisdiction thereof, as the remedy is complete at law.[2]

A co-surety sued at law may show in defense that the surety paying the debt received securities from the principal debtor, and has converted them into money. The proceeds thus retained by the surety are treated as a payment pro tanto of the debt.[3] Nor is it any defense to an action for contribution between co-sureties that the plaintiff, who paid the debt, did not avail himself of the defense of usury, if he had no knowledge thereof.[4] And a party who has signed a note as surety for one who is himself only a surety for the principal maker, is not liable in a suit for contribution.[5]

[1] Griffin *v.* Kelleher, 132 Mass. 82; Brigden *v.* Cheever, 10 Mass. 450, 454; Chaffee *v.* Jones, 19 Pick. 260, 265; Wood *v.* Leland, 22 Ib. 503, 506; Cary *v.* Holmes, 16 Gray, 127; Morgan *v.* Smith, 70 N. Y. 537; Dodd *v.* Winn, 27 Mo. 503; Magruder *v.* Admire, 4 Mo. App. 133; Cowell *v.* Edwards, 2 B. & P. 268; Brown *v.* Lee, 6 B. & C. 689; Batard *v.* Hawes, 2 El. & Bl. 287; Wright *v.* Hunter, 5 Ves. 792; Craythorne *v.* Swinburne, 14 Ib. 160. The right is supported as against the estate of the deceased co-surety. Conover *v.* Hill, 76 Ill. 342.

[2] Allen *v.* Wood, 3 Ired. Eq. 386.

[3] Paulin *v.* Kaighn, 29 N. J. L. 480.

[4] Warner *v.* Morrison, 3 Allen, 566.

[5] Robertson *v.* Detherage, 82 Ill. 511; Salyers *v.* Ross, 15 Ind 130

CHAPTER XXIV.

THE DISCHARGE OF THE SURETY.

§239. The surety's discharge, upon creditor's surrender or loss of collaterals.
240. The rule as to collateral securities limited and illustrated.
241. Mere inaction of creditor as to collateral securities, no discharge.
242. Acceptance of collateral security, without more, no discharge.
243. Acceptance of new security of principal, discharges surety.
244. Discharge by misrepresentations as to collateral securities by creditor.
245. Discharge of surety by changes in the instrument.
246. Surety when not released in cases of forgery.
247. Release of surety, by extension of time to principal.
248. When surety not released, by extension of time.
249. Like rules as to sureties upon specialties.
250. Rights against surety reserved upon release of principal or co-surety.
251. Discharge of deceased surety's estate, as to creditors.
252. No discharge of such estate, as to co-sureties.

§ 239. SURETY'S DISCHARGE, UPON CREDITOR'S SURRENDER OR LOSS OF COLLATERALS.—A surety is discharged from his liability on the principal obligation by any affirmative act of the creditor by which the terms of the contract of suretyship are changed to the prejudice of the surety, without his consent. Such discharge results from a valid and definite extension of time, or by unauthorized changes in the instrument, or by new duties and responsibilities imposed upon the principal, or by the conduct of the creditor in relation to collateral securities received by him from the principal debtor to secure the payment of the debt. A creditor holding collateral securities is chargeable with a trust concerning the same for the benefit of the surety, where he has notice of the existence of such relation as between the parties to the note. By his voluntary accept-

ance of such securities, the creditor assumes responsibilities in relation thereto not ordinarily undertaken by the holder of paper upon which are the names of a principal and surety. The personal obligation of the surety to pay the note upon default of the principal, is not affected by the receipt of such collateral securities by the holder from the debtor, but the interest of the surety in the proper management and realization of such securities is recognised, at law and in equity. If the creditor by an act of a positive character, or by his gross negligence or bad faith, and without the knowledge and consent of the surety, releases, surrenders, impairs, destroys, or fraudulently transfers such collateral securities so as to defeat any claim of the surety, upon payment of the debt, to be subrogated thereto for his indemnification, the surety is discharged to the extent of his actual loss, at any rate, and of his whole liability in cases of fraud or negligence so gross as to raise a presumption of fraud.[1] And

[1] Guild *v.* Butler, 127 Mass. 388; Wilcox *v.* Fairhaven Bank, 7 Allen, 272; Merchants' Bank *v.* Baker, 4 Met. 164; Eastman *v.* Foster, 8 Ib. 19; Stewart *v.* Davis, 18 Ind. 74; Cheesebrough *v.* Millard, 1 Johns. Ch. 409; Griswold *v.* Jackson, Ib. 430; Hayes *v.* Ward, 4 Ib. 123; Ingalls *v.* Morgan, 10 N. Y. 178; Chester *v.* Kingston Bank, 16 Ib. 336; Lewis *v.* Palmer, 28 Ib. 271; Supervisor *v.* Otis, 62 Ib. 88; New Hampshire Savings Bank *v.* Colcord, 15 N. H. 119; New London Bank *v.* Lee, 11 Conn. 112; Belcher *v.* Hartford Bank, 15 Ib. 480; Pratt's case, 16 La. Ann. 357; Priest *v.* Watson, 75 Mo. 315; Clopton *v.* Spratt, 52 Miss. 251; Nelson *v.* Munch, 28 Minn. 314; Springer *v.* Toothaker, 42 Me. 381; Moore *v.* Gray, 26 Ohio St. 525; Waite *v.* Dennison, 51 Ill. 319; Dillon *v.* Russell, 5 Neb. 484; Smith *v.* McLeod, 3 Ired. Ch. 390; Miller *v.* Ord, 1 Pa. St. 382; Clow *v.* Derby Coal Co., 98 Ib. 432; Neff's App. 9 W. & S. 36; Hurd *v.* Spencer, 40 Vt. 581; Austin *v.* Belknap, 54 Ib. 495; Brinton *v.* Gerry, 7 Bradw. 238; Kirkpatrick *v.* Howk, 80 Ill. 122; Rogers *v.* School Trustees, 46 Ib. 428, 434; Phares *v.* Barbour, 49 Ib. 370; Darst *v.* Bates, 95 Ib. 513; Cherry *v.* Miller, 7 Lea, 305. The rule is applied to indorsers: Ross *v.* Jones, 22 Wall. 576; Bank *v.* Hatch, 6 Pet. 258; McLemore *v.* Powell, 12 Wheat. 556; Bank *v.* Haurick, 2 Story, 416; Wood *v.* Bank, 9 Cow. 194; Newcomb *v.* Raynor, 21 Wend. 108. Aldrich *v.* Cooper, 8 Ves. 388, 395; Wright *v.* Morley, 11 Ib. 22; Capel *v.* Butler, 2 Sim. & St. 457; Strange *v.* Fooks, 4 Giff. 412; Wulff *v.* Jay, L. R. 7 Q. B. 756; Rees *v.* Barrington, 2 W. & T. Lead. Cas. Eq. 1003. And courts of law will, in proper cases, apply the rule.

under the tendency of modern legislation and decisions, the surety is entitled to interpose in an action at law by the creditor the like defenses, as above stated, as in equity. His discharge results in the one case equally as in the other.[1]

The like rule applies where a person pledges his property as collateral security for the performance of the contract of a third person. Such property stands in the position of a surety, and any changes in the contract of suretyship which would discharge a surety discharges the property held as collateral security.[2] So, where land subject to a judgment lien is sold by the judgment debtor to a third person for its full value, it is regarded as standing in a suretyship relation, and is subject to be discharged from such lien like any other collateral security by the affirmative acts of the creditor or by his gross negligence.[3]

§ 240. THE RULE AS TO COLLATERAL SECURITIES LIMITED AND ILLUSTRATED.—A limitation imposed upon the rule stated under which a surety is discharged by any affirmative act of the creditor surrendering, impairing or destroying the collateral securities held by him from the principal debtor is, that such security must be a mortgage, pledge, lien, or some right to or interest in property, which

Kirkpatrick *v.* Howk, 80 Ill. 122; Rogers *v.* School Trustees, 46 Ill. 428; People *v.* Jansen, 7 Johns 332; Chester *v.* Bank of Kingston, 16 N. Y. 337; Guild *v.* Butler, 127 Mass. 386; Baker *v.* Briggs, 8 Pick. 122; Carpenter *v.* King, 9 Met. 311; Horne *v.* Bodwell, 5 Gray, 457.

[1] People *v.* Jansen, 9 Johns. 332; Baker *v.* Briggs, 8 Pick. 121; Rogers *v.* School Trustees, 46 Ill. 428; Kirkpatrick *v.* Howk, 80 Ib. 122; Neff's App. 9 W. & S. 36; Mayhew *v.* Crickett, 2 Swanst. 185; Philpott *v.* Briant, 4 Bing. 117; Samuel *v.* Howarth, 2 Mer. 287.

[2] Rowan *v.* Sharp Rifle Man. Co., 33 Conn. 18, 22, 24; White *v.* Ault, 19 Geo. 551; Christener *v.* Brown, 16 Iowa, 130; Ryan *v.* Shaw, 14 Ill. 20; Crawford *v.* Richeson, 101 Ib. 351; Barnes *v.* Mott, 64 N. Y. 377; Denison *v.* Gibron, 24 Mich. 187; Union Bank *v.* Ewan, 18 Miss. 333; Robinson *v.* Magee, 1 Ves. Sr, 251; Royal C. Bank *v.* Payne, 19 Grant's Ch. 180.

[3] Barnes *v.* Mott, 64 N. Y. 377; Lowery *v.* McKinney, 68 Pa. St. 294; Leffingwell *v.* Fryer, 21 Wis. 392.

a creditor can hold in trust for the surety, and to which the surety, if he pay the debt, can be subrogated; and the right to apply and to hold must be absolute.[1] Nor will it apply to a statutory remedy, such as a right of distraint. Although after payment of the debt by the surety, he is subrogated to this right, as to the unexpired term of the lease.[2] Nor to the surrender of securities which have become void or valueless.[3]

The surety is discharged where collateral securities held by the creditor from the principal debtor are voluntarily returned without the consent of the surety, at least to the value of such collateral securities.[4] And where a debtor executes a mortgage or deed of trust, or other security, for the benefit of the creditor, the trust thus created for the sureties, bound for the payment of the debt, may not be discharged by any surrender or act in connection with such securities discharging the same, without the consent of the surety.[5] The surety is released, if a right of subrogation to securities be absolutely defeated by the supine negligence of a creditor to comply with statutory

[1] Glazier *v.* Douglass, 32 Conn. 399; Clow *v.* Derby Coal Co. 98 Pa.St. 432; Phares *v.* Barbour, 49 Ill. 370: Billings *v.* Sprague, Ib. 509; Waite *v.* Dennison, 51 Ib. 319; Loomis *v.* Fay, 24 Vt. 240.

[2] Hull *v.* Hoxsey, 84 Ill. 616.

[3] Union National Bank *v.* Crowley, 27 La. Ann. 202.

[4] Kirkpatrick *v.* Howk, 80 Ill. 122; Rozet *v.* McClellan, 48 Ib. 345; Cherry *v.* Miller, 7 Lea, 305; Springer *v.* Toothaker, 43 Me. 381; Austin *v.* Belknap, 54 Vt. 495; Taylor *v.* Jeter, 23 Mo. 244; Saline County *v.* Buil, 65 Ib. 63; Perrine *v.* Firemen's Ins. Co. 22 Ala. 575; Pittsburgh *v.* Thompson, 3 Grant's Cas. 114; Philbricks *v.* McEwen, 29 Ind. 347; Barrow *v.* Shields, 13 La. Ann. 57; Neff's App. 9 W. & S. 36; Holt *v.* Body, 18 Pa. St. 207; Everly *v.* Rice, 20 Ib. 297; Denny *v.* Lyon, 38 Ib. 98; Commonwealth *v.* Vanderslice, 8 S. & R. 452; Clopton *v.* Spratt, 52 Miss. 251. And where the creditor permits the debtor to take and sell such security, and retain the proceeds. Rable *v.* Newman, 7 Bush, 584. The rule is not affected even by the substitution of security of greater value than that surrendered, without the consent of the surety. N. H. Savings Bank *v.* Colcord, 15 N. H. 119.

[5] Clow *v.* Derby Coal Co. 98 Pa. St. 432; Phares *v.* Barbour, 49 Ill. 370; Billings *v.* Sprague, Ib. 509; Waite *v.* Dennison, 51 Ib. 319.

requirements requisite to its validity and preservation.[1] Or where such collateral securities have been received by the creditor after the maturity of the debt and the proceeds thereof misappropriated to other debts to the injury and loss of the surety.[2] The surety is also discharged where the creditor fraudulently treats such securities as his own so that the surety is damnified,[3] or has released the principal debtor from a judgment, entered against him or suspended his right of action against him upon the principal debt without the surety's consent.[4]

§ 241. MERE INACTION OF THE CREDITOR AS TO COLLATERAL SECURITIES NO DISCHARGE.—In the absence of an express agreement to use diligence, or of such special circumstances as to render prompt action of the creditor an absolute duty, the mere inaction or passive delay, or omission of the creditor to enforce the collection of collateral securities held by him from the principal debtor, is not sufficient of itself to discharge or release a surety from his obligation to pay the debt upon default.[5] Nor is a failure

[1] Curry *v.* Mack, 90 Ill. 606; Rogers *v.* School Trustees, 46 Ib. 428; Burr *v.* B yer, 2 Neb. 265; Philbrooks *v.* McEwen, 7 Bush, 564; Ducker *v.* Rapp, 67 N. Y. 464; Lang *v.* Brevard, 3 Strobh. Eq. 59; Strange *v.* Fooks, 4 Giff. 412; Wulff *v.* Jay, L. R. 7 Q.B.756; Rainbow *v* Juggins, L. R. 5 Q.B D. 138; Rees *v.* Barrington, 2 W. & T. Lead. Cas. 1003.

[2] Smith *v.* Clopton, 48 Miss. 66; Rosborough *v.* McAliley, 10 S. C. 235; Chaffee *v.* Talliaferro, 58 Miss. 544.

[3] Clopton *v.* Spratt, 52 Miss. 251.

[4] Case *v.* Hawkins, 53 Miss. 702; Pomeroy *v.* Tanner, 70 N. Y. 547, cases of indorsers.

[5] Winton *v.* Little, 94 Pa. St. 64; Est. of Bush., 12 Phila. 53; Kindt's Appeal, 102 Penn. St. 441; Board of Supervisors *v.* Otis, 62 N. Y. 88; Clark *v.* Sickler, Ib. 231; Thompson *v.* Hall, 45 Barb. 214; Fulton *v.* Matthews, 15 Johns. 433; Reynolds *v.* Ward, 5 Wend 501; Marsh *v.* Dunkel, 25 Hun, 167; Cherry *v.* Miller, 7 Lea, 305; Clopton *v.* Spratt, 52 Miss. 251; Dundas *v.* Sterling, 4 Pa. St. 73; Miller *v.* Knight, 7 Baxt. 127; Richardson *v.* Ins. Co. 27 Gratt, 749; Pharr *v.* McHugh, 32 La. Ann. 1280; Pearl *v.* Williams, 11 Ill. 253; Villars *v.* Palmers, 67 Ib. 204; Rozet *v.* McClellan, 48 Ib. 345; Orme *v.* Young, Holt, 84; Goring *v.* Edmonds, 6 Bing. 94; Strong *v.* Foster, 17 C. B. 216; Bank *v.* Beresford, 6 Dow. 233; Holl *v.* Hadley, 2 A. & E. 758; Eyre *v.* Everett, 2 Russ. 381.

of the holder of a negotiable promissory note, having a lien on personal property of the principal debtor, to enforce the same a discharge of the surety, although the security has become worthless.[1] The failure of a creditor to record a mortgage given by the principal debtor as security for the debt, no positive act of the creditor occurring but only mere delay and omission,[2] or to revive a judgment against the principal debtor, so that a lien on land is lost, and the property passed into the hands of subsequent creditors, in the absence of an express agreement that it should be kept alive for the benefit of the surety,[3] will not operate as a discharge.

A surety is not discharged even where the creditor has given positive order to delay enforcing an execution against the principal debtor.[4] Nor by a failure to levy an execution upon the property of the principal debtor, although by reason thereof it is lost to the surety, unless such surety has required the creditor to enforce the same by proper notice.[5] If by reason of delay in enforcing an execution the principal debtor is enabled to remove his property beyond the reach of process, the surety is not discharged, in the absence of fraud or collusion on the part of the creditor.[6] A discharge of the principal debtor, taken on a *ca. sa.*, is not a release of

The same rule is applied in the case of indorsers. Ross *v.* Jones, 22 Wall. 576; Bank *v.* Myers, 1 Bail. 418; Gwin *v.* Moore, 79 Ind. 103; Powell *v.* Waters, 17 Johns. 179; Stafford *v.* Yates, 18 Ib. 329; Bank *v.* Ives, 17 Wend. 502; Bank *v.* Rollins, 13 Me. 205; Sterling *v.* Marietta etc. Co. 11 S. & R. 182; Kennard *v.* Knott, 4 Mann. & G. 474; Trimble *v.* Thorne, 16 Johns. 159; Beebe *v.* Bank, 7 W. & S. 375; Philpott *v.* Briant, 4 Bing. 717.

[1] Fuller *v.* Tomlinson, 57 Iowa, 111.

[2] New York Nat. Exchange Bank *v.* Jones, 9 Daly, 248; Philbrook *v.* McEwen, 28 Ind. 347; Lang *v.* Brevard, 3 Strobh. Eq. 59; Hampton *v.* Levy, 1 McCord Ch. 107. See Schroeppel *v.* Shaw, 3 N. Y. 459.

[3] Winton *v.* Little, 94 Pa. St. 64; U. S. *v.* Simpson, 3 P. & W. 437. But the release of a principal debtor from a judgment will release the surety. Anthony *v.* Capel, 53 Miss. 350. Or where it is put out of the power of the surety to collect the same. Ducker *v.* Rapp, 67 N. Y. 464.

[4] McNeilly *v.* Cooksey, 2 Lea, 39.

[5] Thompson *v.* Robinson, 34 Ark. 44.

[6] McKenny *v.* Waller, 1 Leigh, 434.

a surety.[1] A failure to sell negotiable bonds deposited as collateral security for the payment of a negotiable promissory note, upon default in the payment of the principal obligation, and the subsequent depreciation in value thereof, forms no defense for a surety upon such note, when sued thereon.[2] Nor will the failure of a bank to appropriate funds of a principal debtor on deposit to the payment of a note at its maturity, be a discharge pro tanto of a surety upon the principal obligation.[3] A material change in the principal instrument discharging a surety, the result is not affected by the fact that such surety holds collateral securities from the principal.[4] And although the estate of a deceased surety is not liable upon his contracts of suretyship, resort is allowed to any collateral securities given to such deceased surety by the principal debtor, and remaining in his possession at the time of his decease.[5]

§ 242. Acceptance of Collateral Security, by Creditor, no discharge. — The receipt by the creditor from the principal debtor of the negotiable promissory note of a third person, indorsed where required, as collateral security for the payment of his own note, the latter bearing also the name of a surety, does not affect the right of such creditor to an action at law against the surety upon the principal note, upon default of payment and proper notice. The fact that such collateral note matures at a time subsequent to the principal note, raises no presumption of any agreement on the part of the creditor to extend the time of payment of the principal note, and the surety is not released. His obligation is entirely independent of any promise contained in the collateral paper. The receipt of such collateral securities by the creditor from the principal debtor is a benefit to the surety, as the latter, upon payment of the

[1] U. S. *v.* Stanbury, 1 Pet. 573.

[2] Cherry *v.* Miller, 7 Lea, 305.

[3] Voss *v.* International Bank, 83 Ill. 599; Nat. Bank *v.* Smith, 66 N. Y. 271.

[4] Rounswell *v.* Wolf, 47 Wis. 253.

[5] Crosby *v.* Crafts, 69 N. Y. 607.

debt, becomes entitled to subrogation thereto, and to enforce the same for his own relief.[1] Where such collateral securities mature before maturity of the principal note, the surety may require the creditor to apply the money collected thereon, in payment pro tanto of the debt and to his relief.[2] In states where the indorsee of negotiable paper as collateral for an antecedent debt, without any further consideration, is not a holder for value, in the usual course of business, the indorsement of such paper to a creditor holding a principal note, upon which a surety is bound, will not release such surety, as no presumption arises by the receipt thereof of any extension of time upon the principal note.[3] A valid agreement for an extension of time, made upon the indorsement and delivery of collateral securities, and in consideration thereof, without the surety's knowledge and consent, discharges the latter.[4] A principal maker of a note, without the knowledge and consent of the surety, borrowed money upon a new note, also signed by sureties, for the purpose of taking up the first note, and upon an agreement to indorse the same to the sureties on the second note as col-

[1] Fireman's Ins. Co. *v.* Wilkinson, 35 N. J. Eq. 160; Hayes *v.* Wells, 34 Md. 512; Brengle *v.* Bushey, 40 Ib. 141; Thurston *v.* James, 6 R. I. 103; Austin *v.* Brooks, 31 Vt. 64; Stevenson *v.* Austin, 3 Metc. 474; Bangs *v.* Strong, 10 Paige, 11; Neimcewicz *v.* Gahn, 3 Paige, 614; Van Etten *v.* Trouden, 67 Barb. 342; Remsen *v.* Graves, 41 N. Y. 471; Wood *v.* Robinson, 22 Ib. 564; Cary *v.* White, 52 N. Y. 138; Hubbard *v.* Gurney, 64 N. Y. 457; Norton *v.* Soule, 2 Greenl. 341; Lincoln *v.* Bassett, 23 Pick. 154; United States *v.* Hodge, 6 How. 279; Cruger *v.* Burke, 8 Tex. 66; s. c. 11 Ib. 694; Wade *v.* Stanton, 6 Miss. 631. The same rule is applied to indorsers: Mohawk Bank *v.* Van Horne, 7 Wend. 117; Globe Ins. Co. *v.* Carson, 31 Mo. 218; Oxford Bank *v.* Lewis, 8 Pick. 458. Pring *v.* Clarkson, 1 B. & C. 14; Twopenny *v.* Young, 3 B. & C. 208; Bedford *v.* Deakin, 2 B. & A. 210; Perfect *v.* Musgrave, 6 Price, 111. Unless it is given as consideration for an extension of time. Liquidators etc. *v.* Same, L. R. 7 H. L. 348.

[2] Lincoln *v.* Bassett, 23 Pick. 154.

[3] United States *v.* Hodge, 6 How. 279; Weakly *v.* Bell, 9 Watts, 280; Gahn *v.* Niemcewicz, 11 Wend. 312; Day *v.* Leal, 14 Johns. 404; Elwood *v.* Diefendorf, 5 Barb. 398, 409; Sigourney *v.* Witherell, 8 Met. 564; Wallace *v.* Agry, 4 Mason, 336; Pring *v.* Clarkson, 1 B. & C. 14; Emes *v.* Widowson, 4 C. & P. 151.

[4] Greene *v.* Bates, 74 N. Y. 333.

lateral security. The money thus obtained having been paid in discharge of the first note, the surety thereon was discharged, and no enforcement thereof as against him was allowed the sureties upon the second note, upon default, although an action against the maker was allowed.[1]

§ 243. Acceptance of new Security of Principal discharges Surety.—The rule that an extension of the time of payment of the debt by the creditor to the principal debtor, without the knowledge and consent of the surety, will discharge the latter, is applied where the holder of a negotiable promissory note receives a new note from the principal debtor, payable at a future day. The acceptance of such new note operates to suspend the right of action upon the principal demand until the maturity of the note, being a sufficient consideration for the extension of time thereon.[2] It is necessary in order to bring the surety within the rule, either that the new note should be taken in payment of the first note, or that the time of payment of the latter should be extended for a definite period.[3] The rule is applied where, on the maturity of the original obligation, the principal debtor pays a portion of the debt, giving a new note for the balance, the creditor retaining

[1] Greening *v.* Patton, 51 Wis. 146.

[2] Hubbard *v.* Gurney, 64 N. Y. 457; Fellows *v.* Prentis, 3 Denio, 510; Bangs *v.* Mosher, 23 Barb. 478; Dorlon *v.* Christie, 39 Ib. 610; Albany etc. Co. *v.* Devendorf, 43 Ib. 444; Place *v.* McIlvain, 38 N. Y. 96; Linn *v.* Neldon, 23 N. J. Eq. 169; Thomson *v.* Bowne, 39 N. J. L., 2; Paulin *v.* Kaighn, 27 Ib. 503; Bell *v.* Martin, 18 Ib. 167; Grover *v.* Hoppock, 26 Ib. 191; Sayre *v.* King, 17 W. Va. 562; First Nat. Bank *v.* Leavitt, 65 Mo. 562. The rule is applied in favor of indorsers: Wood *v.* Jefferson County Bank, 9 Cow. 194; Hill *v.* Bostwick, 10 Yerg 410; Gahn *v.* Niemeewicz, 11 Wend 312; Hurd *v.* Little, 12 Mass. 502; Baker *v.* Walker, 14 M. & W. 465. The mere receipt of a new note from the principal, without a valid agreement to extend the time of payment of the first note, does not discharge the surety. Elwood *v.* Diefendorf, 5 Barb. 398; Cary *v.* White, 52 N. Y. 138, but see Hubbard *v.* Gurney, supra. Moss *v.* Hall, 5 Exch. 50 (Parke, Baron).

[3] Hough *v.* Etna Life Ins. Co., 57 Ill. 118.

possession of the old note. The sureties thereon are discharged, as the creditor, by accepting the new note, has made a valid and definite extension of the time of payment to the principal debtor.[1] The omission to redeliver such old note does not of itself change or affect the contract of extension of time for payment, nor render the same invalid.[2] Sureties upon the original note, however, are not discharged, where the new note is void on account of forgery, although the other be destroyed.[3]

§ 244. Discharge by misrepresentations as to Collateral Securities by Creditor.—Where a creditor or the holder of a promissory note, signed by a principal and surety, induces the latter, by fraudulent misrepresentations about the surety's liability, to release or forego the obtaining of collateral security or other indemnity from the principal debtor, and the surety thereby suffers loss or damage, such creditor or holder is estopped as against such surety, to enforce any claim to the extent of such loss or damage.[4] The failure to communicate a fact to a surety, or a misrepresentation thereof, made in respect to the subject matter of the contract of suretyship, in order that the rules of equitable estoppel may be invoked to protect the surety, must have the effect necessarily of increasing the responsibilities of the surety, or operate to his prejudice and loss.[5] The

[1] Andrew *v.* Marrett, 58 Me. 540; Fellows *v.* Prentiss, 3 Denio, 512; Putnam *v.* Lewis, 5 Johns. 389; and to indorsers, Bailey *v* Baldwin, 7 Wend. 280; Mohawk Bank *v.* Van Horne, Ib. 117. Gould *v.* Robson, 8 East, 576; Stedman *v.* Gooch, 1 Esp. N P. 3.

[2] Hubbard *v.* Gurney, 64 N. Y. 457; Hart *v.* Hudson, 6 Duer, 304; Meyer *v.* Wells, 5 Hill, 465.

[3] Emerine *v.* O'Brien, 36 Ohio St. 491; Goodrich *v.* Tracy, 43 Vt. 314; Schofield *v.* Templer, 4 DeG. & J. 429.

[4] High *v.* Cox, 55 Geo. 662; Whitaker *v.* Kirby, 54 Ib. 277; Carpenter *v.* King, 9 Met. 511; Bank *v.* Haskell, 51 N. H. 116; Thomburg *v.* Marden, 33 Ia. 380; White *v.* Walker, 31 Ill. 422; Booth *v.* Storrs, 75 Ill. 438; Roper *v.* Sangamon Lodge, 91 Ill. 518; Baker *v.* Briggs, 8 Pick. 122; Carpenter *v.* King, 9 Met. 511; Emerine *v.* O'Brien, 36 Ohio St. 491.

[5] Comstock *v.* Gage, 91 Ill. 328.

surety is not discharged, where the element of fraud does not intervene in such representations, and the creditor does not intend to mislead, although the collateral securities agreed to be given by the principal debtor are never delivered, others of less value being substituted.[1] Where the creditor is without knowledge, it is no discharge of a surety that he was induced to sign the note by the fraudulent or false misrepresentations of his principal.[2]

§ 245. Discharge of Surety by changes in instrument.—The erasure of the word surety or security in a promissory note, without the consent of the person bound, or the names of other sureties, made without consent, or of an erasure of a seal upon a specialty, changing the legal effect of an instrument, are sufficient to discharge sureties.[3] Where a promissory note is fully executed by a principal and surety and delivered to the payee, and thereafter, without the knowledge of the surety, the name of another person is added thereto as additional surety, the first surety stands discharged,[4] and also where a note is delivered without the name of a co-surety as agreed, and no notice thereof until the principal is insolvent.[5] An exception to the rule that an extension of time for payment to the principal debtor will discharge a surety arises where both parties appear upon the face of the note as joint debtors. The equity of the surety to relief is not

[1] Fitchburgh Savings Bank *v.* Rice, 124 Mass. 72.

[2] Booth *v.* Storrs, 75 Ill. 438; Davis Sewing Machine Co. *v.* Buckles, 89 Ib. 237; Ladd *v.* Trustees, 80 Ib. 233.

[3] Oregon *v.* Allison, 9 Baxter, 459; Blakely *v.* Johnson, 13 Bush, 197.

[4] Berryman *v.* Mauker, 56 Iowa, 150; Dickerson *v.* Miner, 43 Ib. 508; Whicher *v.* Hall, 5 B. & C. 276; Navigation Co. *v.* Rolt, 6 C. B. N. S. 550; Bonar *v.* McDonald, 3 H. L. Cas. 239

[5] Evans *v.* Bremridge, 25 L. J. Ch. 104. If the surety is informed thereof, and suffers the principal to act without objection, he is estopped from setting up the condition to avoid liability on the bond. Wright *v.* Lang, 66 Ala. 389. If he promise to pay, after knowledge, he can only be sued upon his promise. Loving *v.* Dixon, 56 Tex. 75.

preferred in the absence of knowledge of its existence, as against the claims of the creditor or indorsee for value of the note. Clear proof of the knowledge of the creditor or indorsee of the real relations of the parties must be shown to entitle the surety to relief.[1] And it is only in equity and not at law, that relief will be given.[2] The creditor, however, is charged with the equitable claims of the surety where he has knowledge of the true relations of the parties, acquired at any time before he does the act which alters the surety's position.[3]

§ 246. SURETY, WHEN NOT RELEASED IN CASES OF FORGERY.—The forgery of a name of a pretended surety upon a note, by means of which another person is induced to sign as surety, believing such signature to be genuine, is not a discharge of such surety. No defense arises thereupon as against an action upon the note by the creditor, or an indorsee for value, before maturity, without notice.[4] The

[1] Davis *v.* Graham, 29 Iowa, 514; Torrence *v.* Alexander, 84 N. C. 4; McMillan *v.* Parkell, 64 Mo. 286; Albright *v.* Griffin, 78 Ind. 182; Claremont Bank *v.* Wood, 10 Vt. 585; Neil *v.* Heilman, 9 Biss. 358.

[2] Paulin *v.* Kaighn, 27 N. J. Eq. 508.

[3] Guild *v.* Butler, 127 Mass. 386; Harris *v.* Brooks, 21 Pick. 195; Horne *v.* Bodwell, 5 Gray, 457; Carpenter *v.* King, 9 Met. 511; Kennedy *v.* Evans, 31 Ill. 269; Branch Bank *v.* James, 9 Ala. 949; Kelly *v.* Gillespie, 12 Iowa, 55; Smith *v.* Shelden, 35 Mich. 42; Lime Rock Bank *v.* Mallett, 42 Me. 429; Marine Bank *v.* Abbott, 28 Ib. 280; Davis *v.* Barrington, 30 N. H. 524; Wheat *v.* Kendall, 6 N. H. 504; Miller *v.* McCan, 7 Paige, 451; Manchester etc. Co. *v.* Sweating, 10 Wend. 163; Millerd *v.* Thorn, 56 N. Y. 502; Bank *v.* Hoge, 6 Ohio, 18; Orville *v.* Newell, 17 Conn. 97; Burke *v.* Kruger, 8 Tex. 66; Peake *v.* Estate, 25 Vt. 31; Riley *v.* Gregg, 16 Wis. 671; In re Goodwin, 5 Dillon, 144; Poolcy *v.* Harradine, 7 E. & B. 431; Greenough *v.* McClelland, 2 El. & El. 424; Bailey *v.* Edwards, 4 B. & S. 761; Ewin *v.* Lancaster, 7 B. & S. 571; Davis *v.* Stainbank, DeG. M. & G. 696; Oakley *v.* Pasheler, 4 Cl. & F. 207; Liquidators *v.* Liquidators, L. R. 7 Ch. 142; s. c. 7 H. L. 348; Wilson *v.* Lloyd, L. R. 16 Eq. 60, 71; Swire *v.* Redman, L. R. 1 Q. B. D. 536, 542.

[4] York County Ins. Co. *v.* Brooks, 51 Me. 506; Selser *v.* Brock, 3 Ohio St. 302; Stoner *v.* Milliken, 85 Ill. 218; State *v.* Baker, 64 Mo. 167; Stern *v.* People, 102 Ill. 540.

recovery of such creditor or other indorsee for value, without notice, is supported upon the rules of estoppel in pais or equitable estoppel, that where one of two innocent persons must suffer from the fraud and deceit of a third person, he who first trusts such third person and places in his hands the means to commit the wrong, must bear the loss.[1] Sureties are not discharged where a new note, with the names of sureties forged thereon, is given by the principal to the indorsee of the original security, upon which such sureties are bound, although such note was cancelled and destroyed; nor will the surrender of a fictitious and forged security held by the creditor for the benefit of a surety, to whom the same was of no possible use, except as a matter to be held *in terrorem* over other persons, entitle such surety to a decree in equity relieving him from his obligation on the principal note.[2] A surety is not discharged where, having executed a bond on the faith that his principal would also execute the same, which was not done, but an instrument was in fact executed by the principal in the transaction by reason of which the surety became a specialty creditor, and had a right of action.[3]

§ 247. Release of Surety by extension of time to Principal.—A creditor or indorsee of a negotiable promissory note executed in form by a principal and surety, or where the note is executed by both as principals, but the creditor or holder is chargeable with the knowledge that one of the parties is a surety for the other, who agrees with the principal debtor, upon a valuable consideration and by a contract binding upon both parties, to extend the time for the payment of such note for a definite period, without the consent of the surety, discharges the latter absolutely from his obligation. The creditor, by such an undertaking, practically agrees that during such extension, he will not

[1] Selser *v.* Brooks, and Stoner *v.* Milliken, supra.

[2] Loomis *v.* Fay, 24 Vt. 240.

[3] Cooper *v.* Evans, L. R. 4 Eq. 45; Mackintosh *v.* Wyatt, 3 Hare, 562.

receive payment of the debt from any one standing in the position of surety; since, upon payment, the surety would at once be entitled to sue his principal. The surety, being thus deprived of his remedies against his principal under the original contract of suretyship, is discharged of his obligation upon recognized equitable principles. Courts of equity will give him relief by injunction as against an action at law brought by the creditor or holder to enforce his personal obligation upon the principal debt.[1] The same rule applies as to bills of exchange. The acceptor, being the principal debtor, and the other parties sureties, if the holder of the bill, by a valid contract for valuable consideration, gives time for a definite period to the acceptor, the other parties to the bill are discharged from any liability contracted by becoming parties thereto.[2]

In order that an extension of time of payment by the creditor to the principal debtor should have this effect of releasing the surety, it is essential that the agreement for delay should be for a definite time, upon sufficient consideration, and binding upon both parties, and without the consent

[1] Bradshaw *v.* Combs, 102 Ill. 428; First Nat. Bank *v.* Pierce, 99 Ib. 272; Crossman *v.* Wohlleben, 90 Ib. 537; Danforth *v.* Semple, 73 Ib. 170; Woolford *v.* Dow, 34 Ill. 428; Phares *v.* Barbour, 49 Ib. 370; Davis *v.* People, 1 Gilm. 409; Globe Ins. Co. *v.* Carson, 31 Mo. 218; Rucker *v.* Robinson, 38 Ib. 154; Headlee *v.* Jones, 43 Ib. 235; Hosea *v.* Rowley, 57 Ib. 357; Newcomb *v.* Blakeley, 1 Mo. App. 289; Jennison *v.* Stafford, 1 Cush. 168; Greeley *v.* Dow, 2 Met. 176; Paulin *v.* Kaighn, 29 N. J. L. 505; s. c. 29 Ib. 480; Thompson *v.* Bowne, 39 Ib. 2; Gray *v.* Brown, 22 Ala. 273; Bangs *v.* Strong, 10 Paige, 11; s. c. 7 Hill, 250; Fellows *v.* Prentice, 3 Denio, 512; Halliday *v.* Hart, 30 N. Y. 474, 488; Blydenburgh *v.* Bingham, 38 Ib. 371; Merchants' Bank *v.* Wixen, 42 N. Y. 438; Hubbard *v.* Gurney, 64 Ib. 457, 468; a single day will be sufficient, Ducker *v.* Rapp, 67 Ib. 464; Jester *v.* Sterling, 25 Hun, 344; Denick *v.* Hubbard, 34 N. Y. Supr. Ct. 347; Dunham *v.* Countryman, 66 Barb. 268; Brown *v.* Prophit, 53 Miss. 649; Farnsworth *v.* Coots, 46 Mich. 117; Bebout *v.* Bodle, 38 Ohio St. 500; Liquidators *v.* same, L. R. 7 H. L. 348; Howell *v.* Jones, 1 C. M. & R. 97; Philpot *v.* Briant, 4 Bing. 717. Combe *v.* Wolf, 8 Ib. 162; Strong *v.* Foster, 17 C. B. 219; Bailey *v.* Edwards, 4 B. & S. 761.

[2] Philpot *v.* Briant, 4 Bing. 717.

of the surety or indorser.[1] Such extension of time for payment must involve the substitution of a subsequent for a former agreement.[2] Where these considerations exist, whether the extension of time to the principal is beneficial to the surety or not, the latter stands absolutely discharged.[3] A surety may, however, consent to an extension of time to his principal;[4] or may subsequently ratify the agreement entered into by the creditor and the principal debtor for such extension.[5] The surety may also waive his right of release by entering into a new agreement, which will be enforced, provided the surety upon making the same was aware of his release from the prior obligation.[6]

§ 248. When Surety not released by extension of time.—The discharge of a surety, where the creditor or holder of the note has given the principal debtor an extension of time for payment, is subject to certain conditions as stated, and does not follow in cases where the requisites of a valid extension do not exist. The surety is not discharged, if the extension of time be granted without a valuable consideration therefor, so that the creditor remains under no legal obligation to delay suit against the principal creditor.[7] A mere promise to pay interest by the principal debtor for

[1] Cherry *v.* Miller, 7 Lea, 305; Gardner *v.* Watson, 13 Ill. 347; Flynn *v.* Mudd, 27 Ib. 323; Danforth *v.* Semple, 73 Ib. 170; Globe Ins. Co. *v.* Carson, 31 Mo. 218; Moss *v.* Hall, 5 Exch. 50; Thompson *v.* Robinson, 34 Ark. 44.

[2] Bebout *v.* Bodle, 38 Ohio St 500.

[3] Dunham *v.* Countryman, 66 Barb. 268; Davis *v.* People, 1 Gilm. 409; Water *v.* Crame, 20 Ill. 148; Warner *v.* Campbell, 26 Ib. 282; Galbraith *v.* Fullerton, 53 Ib. 126; Phares *v.* Barbour, 49 Ib. 390; Danforth *v.* Semple, 73 Ib. 170.

[4] Corbett *v.* Woodward, 5 Sawy. 403; Adams *v.* Way, 32 Conn. 172.

[5] Woolford *v.* Dow, 31 Ill. 424; First Nat. Bank *v.* Whitman, 66 Ib. 331.

[6] Hinds *v.* Ingham, 31 Ill. 400.

[7] Corbett *v.* Woodward, 5 Sawy. C. C. 403, 416; Creath *v.* Sims, 5 How. 192; McKenny *v.* Waller, 1 Leigh, 434; Reynolds *v.* Ward, 5 Wend. 501; Gardner *v.* Watson, 13 Ill. 347; Galbraith *v.* Fullerton, 53 Ib. 126; Liebbrandt *v.* Myron Lodge, 61 Ib. 81; State *v.* Manning, 55 Mo. 142; Denick *v.* Hubbard, 27 Hun. 347; Halliday *v.* Hart, 30 N. Y. 474, 488.

the forbearance, when he already is under a like obligation by the original contract, is not sufficient.[1] If the consideration for the extension be itself illegal, as being usurious, the surety is not discharged.[2] Nor where, the contract for extension having been made with a stranger, the surety may still pay the debt and pursue his remedy against the principal.[3] The surety is not discharged where the extension of time is indefinite, or during the pleasure of the creditor.[4]

Where an extension of time was secured upon the false representations of the principal that the surety had consented thereto and a payment of interest, the creditor, upon discovery of the fraud, was allowed to repudiate the agreement and sue upon the original contract, without refunding or tendering the amount received as interest, the agreement for extension being wholly invalid.[5] The constructive presence of a surety, and his presumed consent, are sufficient to defeat the usual operation of an extension of time upon the obligation of a surety, where in an action against both principal and surety upon a note the principal confesses judgment upon an agreement that execution shall not issue for a year, although without the knowledge of the surety.[6]

§ 249. Like rules as to Sureties upon Specialties.—Sureties bound upon specialties are released from their obligations under like rules as to extension of time. Where a creditor gives an extension of time on a judgment to the principal debtor, the surety is discharged, if such

[1] Reynolds *v.* Ward, 5 Wend. 501.

[2] Real Estate Trust Co. *v.* Leech, 69 N. Y. 248; Church *v.* Malley, 70 Ib. 63; Vilas *v.* Jones, 1 N. Y. 274; National Bank *v.* Place, 15 Hun, 564; Denick *v.* Hubbard, 27 Ib. 347; Wiley *v.* Keight, 39 Mo. 130; Marks *v.* Bank, 8 Ib. 316; Charlotte Bank *v.* Lineberger, 83 N. C. 454. Contra; Wild *v.* Howe, 74 Mo. 551. Where a payment of usury is made, but not in pursuance of a binding agreement, a surety is not discharged. Hemery *v.* Marksberry, 57 Mo. 399.

[3] Frazer *v.* Jordan, 8 El. & Bl. 312.

[4] Thompson *v.* Robinson, 34 Ark. 44.

[5] Bebout *v.* Bodle, 38 Ohio St. 500.

[6] Carraway *v.* Odeneal, 56 Miss. 223; Ammons *v.* Whitehead, 36 Ib. 79.

time be granted without his knowledge and consent.[1] An agreement by parol to extend the time of payment upon a specialty debt, represented by a bond, under seal, being sufficient to bind the creditor, releases a surety, if made without his consent.[2] Relief of the surety, where it is sought to establish a discharge from liability upon a specialty debt or judgment, by reason of an extension of time by parol, must be sought in equity, as it is not available in an action at law upon such bond or judgment.[3] The sureties on a bond were released, where the principal debtor gave the creditor his own promissory note for the same amount, payable in terms at the same time as the time stipulated in the bond, as the maker thereby became entitled to three days of grace for payment beyond the time set by the original security.[4]

§ 250. Rights against Surety reserved, upon release of Principal or Co-surety.—An agreement, upon valuable consideration, by a creditor to release and discharge a principal debtor, but expressly reserving in such instrument of release, and as a part of the same transaction, the right of the creditor to proceed as against a surety bound upon the same obligation, does not affect, in equity or at law, the continuing liability of the latter. Such a covenant operates not as an absolute, but only as a qualified and conditional suspension of the right of action. Necessarily it must be treated as if it were made, in

[1] Boling *v.* Young, 38 Ohio St. 135; Blazer *v.* Bundy, 15 Ib. 57; Sayre *v.* King, 17 W. Va. 562; McNulty *v.* Hurd, 18 Hun, 1. If the surety has by compulsory process paid the judgment to save his goods and chattels from forced sale, he is entitled to recover from the judgment creditor the amount so paid, and the latter is remitted to his remedies against the principal debtor. Boling *v.* Young, supra; Baker *v.* Cincinnati, 11 Ohio St. 534; Denier *v.* Myers, 20 Ib 336; Stephan *v.* Daniels, 27 Ib.527.

[2] Carter *v.* Duncan, 84 N. C. 676.

[3] Witner *v.* Ellison, 72 Ill. 302; Tate *v.* Wymand, 7 Blackf. 240; Lock *v.* U. S. 3 Mason, 446; Davy *v.* Prendergrass, 5 B. & Ald. 187; Parker *v.* Watson, 8 Ex. 404.

[4] Appleton *v.* Parker, 15 Gray, 173.

express terms, subject to the consent of the surety. The rights of the surety, under his contract, can not be limited or destroyed to his loss, by any secret agreement between the principal and creditor. If the latter has surrendered all claims upon the principal debtor, so that they are absolutely unenforceable, the surety is discharged ; if the agreement, however, is in effect only a covenant not to sue the principal, the surety's rights, as against both parties, are not affected, and no discharge results. The surety may at once upon payment proceed against his principal for the money paid to his use; and, in proper cases, will be given equitable relief as against the creditor and principal even before payment.[1] It was sought in an early case to extend the rule to a release by a creditor of one of two or more cosureties, reserving his rights against the other sureties,[2] but

[1] Oxley *v.* Storer, 54 Ill. 159; Parmalee *v.* Lawrence, 44 Ib. 405; Mueller *v.* Dobscheutz, 86 Ill. 176 ; Ainsworth *v.* Brown, 31 Ind. 270; McLellan *v.* Cumberland Bank, 24 Me. 566; McAllister *v.* Sprague, 34 Me. 296; Rucker *v.* Robinson, 38 Mo. 154; Farnsworth *v.* Coots, 46 Mich. 117; Greenleaf *v.* Loring, 35 Mich. 63; Clagett *v.* Salmon, 5 Gill & J. 314; Blackburn *v.* Ball, 21 Md. 208; Shaw *v.* Pratt, 22 Pick. 305; Sohler *v.* Loring, 6 Cush. 537; Smith *v.* Bartholamew, 1 Met. 276; Stirewalt *v.* Martin, 84 N. C. 4 ; Charlotte *v.* Lineberger, 83 Ib. 454; Durrell *v.* Wendell, 8 N. H. 369; Snow *v.* Chandler, 10 Ib. 92; Crane *v.* Alling 15 N. J. L. 423; Catskill Bank *v.* Messenger, 9 Cow. 38; Rowley *v.* Stoddard, 7 Johns, 207; Bronson *v.* Fitzhugh, 1 Hill, 185 ; Frink *v.* Green, 5 Barb. 455; Couch *v.* Mills, 21 Wend. 424; Hubbell *v.* Carpenter, 5 N. Y. 171; Morgan *v.* Smith, 70 N. Y. 545; Calvo *v.* Davies, 72 Ib. 211; National Bank *v.* Bigler, 83 Ib. 51, 66; Palmer *v.* Purdy, Ib. 143 ; Burke *v.* Noble, 48 Pa. St. 168; Vicley *v.* Hoag, 24 Vt. 46; Morse *v.* Huntington, 40 Ib. 488, 496; Ex parte Glendenning, Buck, 519; Kearsley *v.* Cole, 16 M. & W. 128 ; Price *v.* Barker, 4 El. & Bl. 760 ; North *v.* Wakefield, 13 Q. B. 541; Bealer *v.* Mayor, 19 C. B. N. S. 76; Solly *v.* Forbes, 2 B. & B. 46; Green *v.* Wyman, L. R. 4 Ch. 204 ; Liquidators *v.* Liquidators, L. R. 7 Ch. 142; s. c. 7 H. L. 348; Muir *v.* Crawford, L. R. 2 H. L. Sc. 456 (a bill of exchange).

[2] Ex parte Gifford, 6 Ves. 505 (Lord Eldon); Stirling *v.* Forrester, 3 Bligh, 591, 596; United States *v.* Murphy, 13 Fed. Rep. 589, recognizes the rule, although under the circumstances of the case, it was not applied. Story's Eq. Jur. § 498 *a*.

the case has been expressly overruled in later decisions.[1] Where such a release has been made, it is no defense to an equitable suit for contribution by other sureties who have paid the debt.[2]

§ 251. Discharge of estate of Surety upon death, as against Creditor.—Upon the death of a surety, bound jointly, his estate is absolutely discharged both at common law and equity as to the creditor, the survivor or survivors alone being responsible. Receiving no part of the consideration of the note either from the creditor or principal debtor, equity finds no moral ground upon which it can rest an obligation to pay, and discharges the estate of the surety after his death.[3] And this, whether the creditor knew the deceased was a surety on the note or not.[4] Where two persons gave a joint and several bond, and the obligee elected to take a joint judgment thereon, and the surety deceased, the obligee was not allowed to enforce such judgment against the estate of the surety,[5] although the surety alone had appealed from such judgment, giving an indemnity bond, the appeal being pending at the time of his death.[6] Where a surety, however, holds security from the principal for the payment of the debt, it remains as available to the creditor after the surety's decease as before.[7]

[1] Nicholson *v.* Revill, 4 Ad. & E. 683; Evans *v.* Bremridge, 25 L. J. Ch. 104; Pledge *v.* Buss, Johns. Eng. Ch. 663.

[2] Clapp *v.* Rice, 15 Gray, 559; Hill *v.* Morse, 61 Me. 541; Crosby *v.* Wyatt, 23 Ib. 163.

[3] United States *v.* Price, 9 How. 83; Pickersgill *v.* Lahers, 15 Wall. 140; Fielden *v.* Lahers, 6 Blatch. 524; Gette *v.* Binsee, 49 N. Y. 385; Wood *v.* Fiske, 63 Ib. 245; Hanck *v.* Craighead, 67 Ib. 432; Risley *v.* Brown, 67 Ib. 160; Dixon *v.* Vandenbergh 35 N. J. Eq. 47. The contra rule is held in Hudelson *v.* Armstrong, 70 Ind. 99; Smith *v.* Martin, 4 Dess. 149.

[4] Dixon *v.* Vandenbergh, 35 N. J. Eq. 47.

[5] United States *v.* Price, supra.

[6] Risley *v.* Brown, 67 N. Y. 160.

[7] Crosby *v.* Crafts, 69 N. Y. 607.

§ 252. NO DISCHARGE OF ESTATE, AS AGAINST CO-SURETIES.—The death of one of two or more sureties will not relieve the estate of a deceased surety from the equitable obligation of contribution to other sureties upon payment of the debt. This obligation of the contract of co-suretyship is rested upon an implied agreement of the parties to contribute towards discharging the liability incurred on behalf of a common principal. Where there has been a default on the part of the principal, before the death of the surety, the obligation to contribute descends upon the representatives of the deceased surety, in like manner as any other contract by him to pay money upon a future event or contingency.[1] The recovery of a surety against the estate of his deceased co-surety in a suit for contribution has been restricted to an aliquot portion of the money, notwithstanding some of the other sureties may be insolvent.[2]

[1] Johnson *v.* Harvey, 84 N. Y. 363; Bradley *v.* Burwell, 3 Den. 61; Tour *v.* Goodrich, 2 Johns. 213; Powell *v.* Smith, 8 Ib. 249; Batchelder *v.* Fisk, 17 Mass. 464; Wood *v.* Leland, 1 Met. 387; Cowell *v.* Edwards, 2 B. & P. 268; Deering *v.* Winchelsea, Ib. 270. Contra: Waters *v.* Riley, 1 H. & G. 305.

[2] Stothoff *v.* Dunham, 10 N. J. L. 181.

CHAPTER XXV.

INDORSERS AND GUARANTORS.

§253. The contracts of the indorser and guarantor.
254. Subrogation of holders to collaterals of accommodation indorsers.
255. Subrogation of accommodation indorser to securities.
256. Contribution and subrogation between successive accommodation indorsers.
257. The indorser, as charged by pledgee of collateral notes.
258. The discharge of the indorser.
259. The law of continuing guaranties.
260. Guaranties of contracts, void or ultra vires.
261. The enforcement of the liability of the guarantor.
262. The guarantor's liability, where creditor holds collateral securities.

§ 253. THE CONTRACT OF THE INDORSER AND GUARANTOR.—The contract of an indorser of a negotiable promissory note is, that the instrument and antecedent signatures are genuine; that he himself has a good title and is competent to bind himself as indorser; that the maker is competent to bind himself and will pay the note at maturity, upon due presentment; otherwise, upon default, he, the indorser, upon due and reasonable notice of dishonor, will pay the same to the indorsee or other holder.[1] The indorser of a bill of exchange belongs to that general class of sureties in which, strictly speaking, there is no suretyship, but in which there is a primary and secondary liability of two persons for one and the same debt; the debt being, as between the two persons, that of one of those persons only, and not equally of both, so that the other, if he should be compelled to pay it, would be entitled to reimbursement by the

[1] Ross *v.* Jones, 22 Wall. 576, 589 (Clifford, Jus).

person by whom (as between the two) it ought to have been paid. As between the indorser and the acceptor, the former is, upon payment, entitled to the securities held by the creditor, and also to sue the acceptor.[1]

A guaranty is a separate, independent contract, by which the guarantor undertakes in writing, for a valuable consideration, to be answerable for the payment of some particular debt, or future debts, or the performance of some duty, in case of the failure of another person primarily liable to pay or perform.[2] Such guaranty is assignable with the notes or other obligations secured thereby.[3] The liability of the guarantor is not extended by implication, the rule of strict construction being applied in his favor.[4] A contract of guaranty is regarded as an irrevocable and absolute engagement to pay the debt upon maturity.[5]

§ 254. Subrogation of Holders to Collaterals of accommodation Indorsers.—The principle of subrogation is applied in favor of the holders of negotiable paper in cases

[1] Duncan *v.* North & S. W. Bank, L. R. 6 App. 1.

[2] Gallagher *v.* Nicholls, 60 N. Y. 438,444; Winchell *v.* Doty, 15 Hun, 1; Brown *v.* Cartes, 2 N. Y. 230; Forbes *v.* Rowe, 48 Conn. 413; Welton *v.* Scott, 4 Conn. 533; Rich *v.* Hathaway, 18 Ill. 548; McMillan *v.* Bank, 32 Ind. 11; Singer Manfg Co. *v.* Littler, 56 Iowa. 601; Dole *v.* Young, 24 Pick. 250; Reigart *v.* White, 52 Pa. St. 440; Wood *v.* Sherman, 71 Ib. 406.

[3] Ellsworth *v.* Harmon, 101 Ill. 274; Webster *v.* Cobb, 17 Ib. 459; First National Bank *v.* Carpenter, 41 Iowa, 518; Waldring *v.* Harring, 28 Mich. 493; Claflin *v.* Ostrom, 54 N. Y. 581; Craig *v.* Parkes, 40 Ib. 181; Ketchall *v.* Barnes, 24 Wend. 456; Cooper *v.* Deitrich, 22 Barb. 516; Partridge *v.* Davis, 20 Vt. 499. Contra: Hayden *v* Weldon, 43 N. J. L. 128; Huck *v.* Hager, 51 Pa St. 459; McDowl *v.* Yeomans, 8 Watts, 361; Smith *v.* Dickinson, 6 Humph. 261; Ten Eyck *v.* Brown, 4 Chandl 151; True *v.* Fuller, 21 Pick. 140. A guaranty is not negotiable, nor does it become so by being indorsed on negotiable paper, the payment of which it is designed to secure. Hayden *v.* Weldon, supra.

[4] Shine *v.* Central Savings Bank, 70 Mo. 524, 533; Schultze *v.* Crane, 64 N. Y. 659; Burns *v.* Burrows 61 Ib 29.

[5] Hernandez *v.* Stillwell, 7 Daly, 360; Tator *v.* Thayer, 47 How. Pr. 180; Russell *v* Clarke, 7 Cranch, 90.

where accommodation indorsers have received collateral securities from the principal debtor. Such holder is, upon failure of the maker to pay, at once subrogated to the securities held by the indorser. Such securities are regarded as in the nature of a quasi trust fund.[1] Where such security is expressly given, as well for the benefit of the holder as for the indorser, upon an assignment thereof to a third person, with notice, the equitable lien of the holder of the paper will be preferred.[2] Such securities may be transferred by the indorser to the holder upon default of the principal, and the proceeds applied to the payment of the note,[3] and is sustained where, upon dishonor of the old paper, new notes are given, it being the intention of the parties to keep alive the security.[4] Where the indorser still retains possession of the collateral securities, a court of equity will require them to be applied in payment of notes when indorsed to an innocent holder for value, in the usual course of business.[5] And the misappropriation of the proceeds thereof by a trustee in whose possession the securities had been placed, will not limit the liability of the maker or accommodation indorser to such holder for value.[6] Where both the maker and indorsers are insolvent, the holders for value of negotiable paper are entitled, as against creditors, to the enforcement of securities given to such indorsers as indemnity, although their liability has not become absolute, nor been discharged.[7] Upon insolvency of the principal debtor, the holders of notes

[1] Burnside *v.* Fetzner, 63 Mo. 107; Haven *v.* Pippin, 18 Ib. 136; National Exch. Bank *v.* Silliman, 65 N. Y. 475; Bennett *v.* Cook, 45 Ib. 268; Curtis *v.* Tyler, 9 Paige, 432; Vail *v.* Foster, 4 N. Y. 312; Homer *v.* Savings Bank, 7 Conn. 478; Ohio Life Ins. Co. *v.* Ledyard, 8 Ala. 866; Butler *v.* Berkie, 13 Ohio St. 514; Roberts *v.* Colvin, 3 Gratt. 358.

[2] Hudson etc. Transfer Co. *v.* National Bank, 46 Conn. 573.

[3] Wells *v.* Smith, 2 Utah, 39.

[4] National Bank *v.* Newburgh, 83 N. Y. 51; Pond *v.* Clarke, 14 Conn. 334; Nightingale *v.* Chaffee, 11 R. I. 609.

[5] New London Bank *v.* Lee, 11 Conn. 112; Lewis *v.* DeForest, 20 Ib. 440.

[6] Fischer *v.* Meyer, 24 Mo. 90.

[7] National Bank *v.* Small, 7 Fed. Rep. 83; Rogers *v.* Abbott, 128 Mass. 102.

are entitled to subrogation to securities held by an accommodation indorser under an agreement for his general indemnity, not to exceed a certain sum.[1] The holder may prove for the full amount against the estate of the insolvent principal, notwithstanding securities are held by the accommodation indorser.[2]

But where the holder of a bill, being informed that the acceptor is an accommodating party, holding collateral securities, and makes an express renunciation of any claim thereon, agreeing to look to the drawer for payment, the accommodation acceptor is discharged, and other creditors acquiring rights to such securities are protected.[3] The holders of notes are not permitted to resort to property where one of two mortgages received by an indorser as security from his principal, was released as being unnecessary for his indemnification. The release was made after the insolvency of the maker and indorser for the purpose of securing a further loan, which was advanced by an innocent person.[4] Nor where the right has been defeated by the acts of the holder himself, seeking such subrogation;[5] and, pending the creation of other equities, the indorser holding securities for his general indemnification, may release such security, as he pleases.[6]

[1] Post *v.* Tradesman's Bank, 28 Conn. 421; Thrall *v.* Spencer, 16 Ib. 139; Lewis *v.* De Forest, 20 Ib. 427; Homer *v.* Savings Bank, 7 Ib. 478.

[2] Meed *v.* Nelson, 8 Gray, 55; Cabot Bank *v.* Bodman, 11 Ib 134.

[3] Whartley *v* Tricker, 1 Campb. 351; Parker *v.* Leigh, 2 Stark. 229.

[4] Thrall *v.* Spencer, 16 Conn. 139. The Court say: "T. had no legal title. The first mortgage was not made to the holders of these notes, but to the accommodation indorser for his security. Even if A. were still the owner of the property, the plaintiff could only reach it through the intervention of a court of equity. But he has taken the notes without making any claim for the property, while A. retained the title. He has lain still until the latter has parted with the title and the possession, and the property has gone into the hands of a bona fide holder for a valuable consideration. He therefore comes too late for relief."

[5] New Bedford Inst. *v.* Fairhaven Bank, 9 Allen, 125.

[6] Jones *v.* Quininipiack Bank, 29 Conn. 25; Post *v.* Tradesman's Bank, 28 Ib. 421; Thrall *v.* Spencer, 16 Ib. 139.

§ 255. Subrogation of Accommodation Indorsers to Securities.—The subrogation of the accommodation indorser to the securities held by the creditor or holder for value is subject to the condition that he shall have himself first paid or discharged the note. Nor can the indorser insist, after his liability for the debt is fixed, that the creditor or holder should first exhaust the collaterals held by either of them from the principal debtor before enforcing his personal liability upon the principal note.[1] Prior payment is also necessary to entitle the accommodation acceptor of a bill of exchange to subrogation to collateral securities of the creditor or holder of the negotiable paper.[2] Where a judgment is rendered on the debt, an indorser upon payment is subrogated to the rights of the creditor against the maker thereunder.[3] The right of subrogation is restricted to securities held for the particular debt, and does not extend to all the securities which may be held by the creditor upon a general account.[4] The right to such securities, being a mere equity, is not preferred as against equities of creditors equally deserving, where so to do would be to sanction a fraud upon such creditors.[5] The principle of subrogation has no application in a case where a new note, with a new accommodation indorser, is taken by a bank in payment of another note, signed by other indorsers. The indorser of the new note being a mere volunteer, is not entitled to subrogation to a judgment held as indemnity by the indorser of the former note.[6]

[1] First National Bank *v.* Wood, 71 N.Y. 405, 411; Beebe *v.* Banks, 7 W. & S. 375; Cottrell's App. 23 Pa. St. 294; in re Babcock, 3 Story, 393; Ross *v.* Jones, 22 Wall. 576, 592. But where a bank had a lien in the nature of security on the principal's stock, as in Union Bank *v.* Laird, 2 Wheat. 390, resort thereto would be more equitable than to sue an indorser, who was only liable upon the default of the acceptor.

[2] Bank of Toronto *v.* Hunter, 4 Bosw. 646.

[3] Ross *v.* Jones, 22 Wall. 586; Lenox *v.* Prout, 3 Wheat. 525; Hunt *v.* Brigham, 2 Pick. 581; Frye *v.* Barker, 4 Ib. 382; Trimble *v.* Thorne, 16 Johns. 153; Warner *v.* Beardsley, 8 Wend. 199; s. c. 6 Ib. 610.

[4] City Bank *v.* Luckie, L. R. 5 Ch. 774 *n.*; Wright *v.* Morley, 11 Ves. 12.

[5] Greer *v.* Bush, 57 Miss. 575.

[6] Webster's App. 86 Pa. St. 409.

§ 256. Contribution and Subrogation between successive Accommodation Indorsers.—The liability of parties to negotiable instruments is determined by the contract established by the position of their names upon the paper, and if the right of contribution between two or more persons whose names appear on negotiable paper can not be supported under such contract, no enforcement thereof can be had.[1] Where one of two accommodation parties executes a note as a joint maker with the principal debtor and the other as payee and indorser, the former is not, after paying the note, in the absence of a special agreement, entitled to contribution as against the latter.[2] And one of two accommodation indorsers on promissory note having paid the note, was not allowed to sue for contribution.[3] An accommodation indorser, holding collaterals from the principal, who sold the same for the exact amount of the note, which he paid, is not entitled to an action against prior accommodation indorsers, as the note was paid with the proceeds of the collaterals. If the money had still remained in the hands of the indorser, it would have been devoted to the payment of the note, to avoid further litigation.[4] And where the indorser of a note was a non-resident, and not a party to the action, nor to a cross-claim by the maker insisting upon equitable defenses as against the holder, the maker was not allowed subrogation to securities held by the holder from such indorser, whose alleged fraud had wronged the maker.[5] The principle of subrogation is applied for the benefit of successive indorsers. The last indorser having paid the judgment for the debt, he may take an assignment

[1] West Boston Savings Bank *v.* Thompson, 124 Mass. 506, 514; Longley *v.* Griggs, 10 Pick. 121; Smith *v.* Smith, 1 Dev. Eq. 173; Braham *v.* Ragland, 3 Stew. (Ala.) 247; Post *v.* Tradesman's Bank, 28 Conn. 421; Farmers' Bank *v.* Van Metter, 4 Rand. 553; McCarty *v.* Roots, 21 How. U. S. 432.

[2] Hillegas *v.* Stephenson, 75 Mo. 118.

[3] Lane *v.* Stacey, 8 Allen, 411. Unless by special agreement, Drake *v.* Christy, 10 Mo. App. 566.

[4] Rowland *v.* Smith, 49 Conn. (15 Rep. 710.)

[5] American Nat. Bank *v.* Harrison Wire Co., 11 Mo. App. 446.

thereof in order to enforce payment by preceding indorsers.[1]

§ 257. The Indorser, as charged by Pledgee of collateral Notes.—As between the parties to a contract of pledge, the holder of negotiable instruments as collateral security is not held to strict rules as to demand and notice of non-payment. His failure in this respect will not discharge the pledgor from his principal debt, although the latter may be credited thereon with actual loss.[2] Upon an action against a holder of such securities for neglecting to protest a note, and thus discharging an indorser, the recovery is limited to the sum which will be a full satisfaction for the damages, subject to equitable deduction where the creditor holds other securities for the debt.[3] An indorser is discharged where a notary public upon demanding payment of the maker fails to produce the collateral securities held by the pledgee to secure its payment.[4] It is no defense to an action against an indorser upon a note discounted by a bank, that at the time of the discount, it was understood that the bank would rely upon certain collateral securities rather than the indorser. Such an agreement, if it had a valuable consideration, would not affect the liability of parties to the principal note.[5] Where, however, an indorser holding a promissory note as security, had been discharged on the principal debt, but waived the want of notice and paid the same, he was not permitted to enforce the collateral note for his own benefit, upon his voluntary payment of the principal note.[6]

[1] Lloyd *v.* Barr, 11 Pa. St. 41.

[2] Douglass *v.* Reynolds, 7 Pet. 125; s. c. 12 Ib. 497; Wildes *v.* Savage, 1 Story, 22; Russell *v.* Hester, 10 Ala. 535; Whitten *v.* Wright, 34 Mich. 92.

[3] Mott *v.* Havana Bank, 22 Hun, 354; Allen *v.* Suydam, 20 Wend. 321; First National Bank *v.* Fourth National Bank, 77 N. Y. 320, 329; Borup *v.* Meininger, 5 Minn. 523.

[4] Ocean Nat. Bank *v.* Faut, 50 N. Y. 274; see Spalding *v.* Bank, 9 Pa. St. 28; Stuart *v.* Bigler, 98 Ib. 80.

[5] West Boston Savings Bank *v.* Thompson, 124 Mass. 506, 514.

[6] Bachellor *v.* Priest, 12 Pick. 279.

§ 258. THE DISCHARGE OF THE INDORSER. — The liability of an indorser of negotiable paper, bills and notes, is limited and dependent upon the condition that the holder of the paper shall have made demand of payment at maturity and upon default has given notice of non-payment to the indorsers. Should the holder omit to perform these essential duties the indorser stands discharged.[1] Where securities are held by an indorser specially for his own benefit, whether received at the time of indorsement or later, and a failure has been made as to demand and protest, so that he is discharged from his liabilities, the holder of the note has no right to complain if he return such securities to the maker.[2] Demand and notice of dishonor are not required to charge an indorser where he has received from the principal an assignment of the whole of his property, or of so much thereof as is clearly equal in value to the notes upon which the indorser is bound, and is holding the same at the maturity of the note.[3] Although where such indemnity is limited to "legal obligations," the indorser of notes is discharged if proper demand and protest be not made.[4] The general rules under which an indorser is discharged in cases

[1] Lenox *v.* Pratt, 3 Wheat. 520; Bailey *v.* Buchanan, 21 Kan. 474; Clark *v.* Devlin, 2 P. & B. 366.

[2] Ray *v.* Smith, 17 Wall. 411; Holland *v.* Turner, 10 Conn. 308; Haskell *v.* Boardman, 8 Allen, 38; Creamer *v.* Perry, 17 Pick. 332; Marshall *v.* Mitchell, 35 Me. 221; Moses *v.* Ela, 48 N. H. 557; Spencer *v.* Harvey, 17 Wend. 489; Seacord *v.* Miller, 13 N. Y. 55; Wilson *v.* Senior, 13 Wis. 380.

[3] Stephenson *v.* Primrose, 17 Ala. 155; Holland *v.* Turner, 10 Conn. 308; Marine Bank *v.* Smith, 18 Me. 99; Marshall *v.* Mitchell, 34 Ib. 221; Lewis *v.* Kramer, 3 Md. 265. 291; Walters *v.* Monroe, 17 Ib. 154; Duvall *v.* Farmers' Bank, 9 G. & J. 31; Hill *v.* Martin. 12 Lea, 177; Coddington *v.* Davis, 3 Den. 16; s. c. 1 N.Y. 186; Benedict *v.* Coffe, 5 Duer, 233, 266; Mechanics' Bank *v.* Griswold, 7 Wend. 165; Seacord *v.* Miller, 13 N. Y. 55; Perry *v.* Green, 19 N. J. L. 61; Kramer *v.* Sandford, 4 W. & S. 328; Durham *v.* Price, 5 Yerg. 300; Watkins *v.* Croach, 5 Leigh, 522, 547; Barrows *v.* Hannigan, 1 McLean, 309; Corney *v.* DeCosta, 1 Esp. 303; Whitfield *v.* Savage, 2 B. & P. 277.

[4] Haskell *v.* Boardman, 8 Allen, 38; Moses *v.* Ela, 43 N. H. 557; Denny *v.* Palmer, 5 Ired. 610; Wilson *v.* Senior, 14 Wis. 480.

of extension of time to the principal debtor, or by the surrender or loss of collaterals, or release of property of the principal seized upon execution, or by operation of law, and other recognized causes of discharge, are the same as in the case of sureties[1] and will be found distinguished in the notes of Chapter XXIV.

§ 259. THE LAW OF CONTINUING GUARANTIES.—If one proposes to lend his credit as guarantor for the benefit of another, and wishes to restrict his liability to a particular transaction, he should take care to say so clearly and distinctly in his proposition or contract of guaranty.[2] What form of words will constitute a "continuing guaranty" is a question of construction. Such expressions as "We hold ourselves responsible for the payment of any sum not exceeding $5,000 X may receive of you,"[3] or a guaranty to a bank "of all liabilities to said bank now existing or which may hereafter arise, to the extent of $25,000,"[4] or where the guarantors agreed "to be responsible to you at any time not exceeding $8,000,"[5] or a guaranty to A to pay "unconditionally at all times, any indebtedness of B to the extent and not exceeding the sum of $10,000 for any overdrafts now made, or that hereafter shall be made,"[6] were declared to be continuing guaranties; but "I am willing to go security for the amount of $2,500," was not.[7]

Where the contract for a continuing guaranty is in the form of a letter of proposed guaranty addressed generally or to a particular person, notice of the acceptance of the

[1] Priest *v.* Watson, 75 Mo. 315; Smith *v.* Rice, 27 Mo. 505; Bank of United States *v.* Hatch, 6 Pet. 250.

[2] Poughkeepsie City Bank *v.* Phelps, 16 Hun, 158; Rindge *v.* Judson, 24 N. Y. 64; Clark *v.* Burdett, 2 Hall, 219; Mayer *v.* Isaac, 6 M. & W. 605; Coles *v.* Pack, L. R. 5 C. P. 65; Merle *v.* Wells, 2 Campb. 413.

[3] Poughkeepsie City Bank *v.* Phelps, supra.

[4] Lazear *v.* National Bank, 52 Md. 78.

[5] Reynolds *v.* Douglass, 12 Pet. 497.

[6] Davis *v.* Wells, 104 U. S. 159.

[7] Gerson *v.* Hamilton, 30 La. Ann. pt. 1, 737.

same should be given to the guarantor, and that advances will be made on the faith of it. Such notice is essential in order to bind the guarantor.[1] Notice, however, is not required where the contract of guaranty is founded upon some independent consideration from the guarantee, whether for an antecedent debt, or for a present or further advance.[2] Nor where the agreement to accept is contemporaneous with the guaranty.[3] The notice, when required, need not be in writing necessarily, but may be inferred from facts and circumstances.[4]

§ 260. Guaranties of Contracts, void or ultra vires.—The consideration for a guaranty need not be, in the absence of fraud, for any but a nominal sum, so long as it comes within the technical definition of a "valuable consideration."[5] It must, however, be valid, for if the principal contract be void, or there is an absolute want of power to enter into the same, so that the contract can have no validity, no rights can be acquired under a guaranty given for its performance.[6] A defense of ultra vires made by a borrower of money from a corporation, in cases where the funds obtained, or the benefits thereof, are still retained, is not approved by courts of equity. The enforcement of penalties affixed by statutory enactments for violations of charter limitations belongs especially to the

[1] Adams *v.* Jones, 12 Pet. 207, 213; Edmonston *v.* Drake, 5 Ib. 624; Douglass *v.* Reynolds, 7 Ib. 113; Lee *v.* Dick, 10 Ib. 483; Reynolds *v.* Douglass, 12 Ib. 497; Russell *v.* Clarke, 7 Cranch, 69; Davis *v.* Wells, 104 U. S. 159; Louisville Manuf. Co. *v.* Welch, 10 How. 461, 475.

[2] Davis *v.* Wells, 104 U. S. 159.

[3] Wildes *v.* Savage, 1 Story, 22.

[4] Reynolds *v.* Douglass, 12 Pet. 497; Davis *v.* Wells, supra.

[5] Lawrence *v.* McCalmut, 2 How. 426, 453; Davis *v.* Wells, 104 U. S. 159; Dutchman *v.* Tooth, 5 Bing. N. Cas. 577.

[6] Farmer's Bank *v.* Lang, 87 N. Y. 209; Heidenheimer *v.* Meyer, 42 N. Y. Supr. Ct. 506; s. c. 74 N. Y. 609; Joslyn *v.* Dow, 19 Hun. 494; Banking Company *v.* Rautenberg, 103 Ill. 460; Penn *v.* Borman, 102 Ib. 523; Worden *v.* Salter, 90 Ib. 160; Neustadt *v.* Hall, 58 Ib. 572; Starr *v.* Earle, 43 Ind. 478; McGregor *v.* Railway Co. 18 Q. B. 618; Colman *v.* Eastern Counties Ry Co., 10 Beav. 1.

government. This rule is applied in cases where attempts are made to defeat guaranties upon which money has been innocently advanced. The lender may recover thereon at least to the extent of his advances.[1] A guaranty of coupons was enforced, although the bonds were voidable[2] and usurious interest paid by indorsers upon securing discount of notes will not defeat an absolute guaranty thereof.[3] Where a guaranty has passed into the hands of a holder for value, without notice, it ceases to be affected by equities existing between the original parties.[4]

§ 261. Enforcement of the liability of Guarantors.—Generally, in the absence of contract, express or implied, to sue the principal upon default, the liability of the guarantor becomes fixed at that time without any proceeding by the creditor to collect the debt from the principal debtor. His agreement is, that the principal shall pay the debt at maturity; upon his default, the liability of the guarantor at once begins.[5] Where such guaranty of payment is absolute, mere delay on the part of the creditor to enforce payment from the principal debtor and to give notice of non-payment, is no defense for the guarantor when sued upon his undertaking.[6] A contract of guaranty of collection merely requires the creditor to pursue his remedies against the principal debtor with reasonable diligence

[1] Macon Railroad Co. *v.* Georgia Railroad Co., 63 Ga. 103; Argenti *v.* San Francisco Co., 16 Cal. 255; Baird *v.* Bradley, 55 Ill. 413; McCluer *v.* Railroad Co. 13 Gray, 124; Cary *v.* Railroad Co, 29 Barb. 35; Bissell *v.* Railroad Co., 22 N. Y. 258; Zabriskie *v.* Railroad Co., 23 How. 381; Railroad Co. *v.* Howard, 7 Wall. 413.

[2] Connecticut Mu. Life Ins. Co. *v.* Railroad Co., 41 Barb. 9; Mann *v.* Eckford, 15 Wend. 502.

[3] Lazear *v.* National Bank. 52 Md. 78.

[4] Jackson *v.* Foote. 12 Fed. Rep. 37; Stone *v.* Bond, 2 Heisk. 425.

[5] Singer Manfg. Co. *v.* Hester, 71 Mo. 91; Davis etc. Co. *v.* Jones, 61 Ib. 409; Forbes *v.* Rowe, 48 Conn. 413; Penny *v.* Crane Bros. Man. Co. 80 Ill. 244; Stowell *v.* Raymond, 83 Ib. 120; Hunter *v.* Moul, 98 Pa. St. 13.

[6] Hooker *v.* Gooding, 86 Ill. 60.

to judgment and execution and sale, and is applied in cases of ordinary guaranty of payment of a debt. The undertaking of the guarantor in such cases is to pay only after a judgment and execution against the principal debtor have proved fruitless.[1] The failure of a creditor to use due diligence to recover the debt from the principal debtor will defeat any right he may have upon even an absolute guaranty of payment indorsed upon a bond.[2] Where the maker of a promissory note is openly insolvent, no suit is necessary to charge the guarantor;[3] nor, upon default of such insolvent debtor, is notice required to be given by the creditor to the guarantor, as the latter can not be prejudiced by want of notice,[4] especially where the name of the guarantor does not appear upon the note.[5] The liability of the guarantor and of the principal being the same, both must take notice at their peril of a default.[6]

§ 262. The Guarantor's liability where Creditor holds Collateral Securities.—A guarantor is not discharged by the mere receipt of collateral security by the holder of a promissory note, the payment of which is secured by his guaranty. The giving of such security by the maker is without effect upon the independent obligation of

[1] Evans *v.* Bell, 45 Tex. 553; Shepheard *v.* Phears, 35 Ib. 763; Day *v.* Elmore, 4 Wis. 190; Moakley *v.* Riggs, 19 Johns. 69; Taylor *v.* Bullen, 6 Cow. 624; Burt *v.* Fowler, 5 Barb. 501; Loveland *v.* Sheppard, 2 Hill, 139; Manning *v.* Haight, 15 Barb. 76; Newell *v.* Fowler, 23 Ib. 628; Cady *v.* Sheldon, 38 Ib. 102; Griffith *v.* Robertson, 15 Hun, 344; N. F. Ins. Co. *v.* Wright, 76 N. Y. 445.

[2] Seipple's App. 100 Pa. St. (14 C. L. J. 417.)

[3] Crag *v.* Parkis, 40 N. Y. (1 Hand) 181; McClerg *v.* Fryer, 15 Pa. St. 393; McDoal *v.* Yeomans, 8 Watts, 361; Bull *v.* Bliss, 30 Vt. 127; Dana *v.* Conant, Ib. 246; Welton *v.* Scott, 4 Conn. 533; Perkins *v.* Catlin, 11 Ib. 213; Randolph *v.* Sherwood, 26 Ib. 437; Forbes *v.* Rowe, 48 Ib. 413; Gillinghan *v.* Boardman, 29 Me. 79; Sanford *v.* Allen, 1 Cush. 473; Wren *v.* Pierce, 4 S. & M. 91.

[4] Gibbs *v.* Cannon, 9 S. &. R. 198; Reynolds *v.* Douglass, 12 Pet. 497.

[5] Reynolds *v.* Douglass, supra.

[6] Gage *v.* Lewis, 68 Ill. 604; Douglass *v.* Howland, 24 Wend. 35; Hammond *v.* Gilmore, 14 Conn. 479; Somersall *v.* Barnaby, Cro. Jac. 287.

the guarantor. The creditor or holder of such note is not required to resort to the securities of the maker as an absolute preliminary to his action against the guarantor. The only pre-requisite to such action is that the principal shall have made default.[1] The guarantor is required first to pay the debt before he can insist upon the enforcement of such security; or he must be so damnified that it would be inequitable to refuse him subrogation thereto.[2] If the contract of the guarantor be that of mere collection and not of payment, the creditor holding securities from the principal debtor for the payment of the note is required to enforce the same, if they can be realized, before resort is had as against the guarantor upon his personal obligation.[3]

[1] Penny *v.* Crane Bro. Manuf. Co. 80 Ill. 244; Sigourney *v.* Wetherell, 6 Met. 553; Forbes *v.* Rowe, 48 Conn. 413; Welton *v.* Scott 4 Ib. 533.

[2] Darst *v.* Bates, 51 Ill. 439.

[3] Vanderbilt *v.* Schreyer, 21 Hun, 537; Borden *v.* Gilbert, 13 Wis. 670.

PART IV.

QUASI-NEGOTIABLE COLLATERAL SECURITIES.

Div I. — Certificates of Stock.

CHAPTER XXVI.

THE CERTIFICATE OF STOCK.

§263. Documents of title, under indorsement, as collateral security.
264. The certificate of stock.
265. The certificate of stock quasi-negotiable.
266. And approximating to negotiable paper—Bank *v.* Lanier.
267. Indorsements in blank of stock certificates.
268. Blank transfers of stock certificates in England.

§ 263. Documents of title, under indorsement, as Collateral Security. — It has become a very common transaction in the commercial world to use documents and indicia of title, quasi-negotiable under blank indorsement, as certificates of stock, bills of lading, warehouse and cotton-press receipts, and other like symbols of property, as collateral security for the payment of loans and discounts of commercial paper. Such collateral securities are readily converted into funds, and the value thereof is easily determined by the quotations of the great exchanges. The rules of estoppel in pais, or equitable estoppel, are invoked for the protection of the pledgee for value, without notice, of such

quasi-negotiable collateral securities. The representations contained in such documents of title, under indorsement in blank and delivery, are regarded as of equal weight as representations contained in commercial paper, and the transfer thereof carries some of the privileges enjoyed by the indorsee for value of negotiable securities. An innocent pledgee for value of certificates of stock, thus indorsed in blank, with an irrevocable power of attorney to transfer, is vested with an unimpeachable title to the shares of stock. The presumption arises by the possession of certificates of stock indorsed in blank, that the pledgor is the owner, although the certificate and indorsement are in the name of another person. The pledgee's title is protected as against the owner in cases of fraud and misappropriation, where such owner through his mistaken confidence has entrusted to a third person documents or indicia of property, indorsed in blank, so that he has the legal title and apparent ownership, and is thus enabled to deceive an innocent pledgee advancing his money upon the faith thereof. The rules of equitable estoppel are also applied in favor of the bona fide pledgee for value of bills of lading, warehouse receipts, cotton-press notes, and other quasi-negotiable collateral securities.[1]

[1] National Bank *v.* Watsontown Bank, 105 U. S. 17; Pollard *v.* Vinton, Ib. 5; Johnston *v.* Laflin, 103 Ib. 800; Shaw *v.* Railroad Co. 101 Ib. 504; McAllister *v.* Kuhn, 96 Ib. 89; National Bank *v.* Lanier, 11 Wall. 377; The Thames, 14 Ib. 98; Matthews *v.* National Bank, Holmes, 396; Continental Nat. Bank *v.* Elliot Nat. Bank, 7 Fed. Rep 369; Winter *v.* Belmont Mining Co 53 Cal. 428; Bridgeport Bank *v.* N. Y. & N. H. R. R. Co. 30 Conn 270; N. Y. & N. H. R. R. Co. *v.* Schuyler, 34 N. Y. 30; Commercial Bank *v.* Kortright, 22 Wend. 348; McNeil *v.* Tenth Nat. Bank, 46 N. Y. 325; Loeb *v.* Peters, 63 Ala. 243; Allen *v.* Maury, 66 Ib. 10; Smith *v.* Crescent City Transfer Co. 30 La. Ann. 1378; State *v.* North L. Ry Co. 34 Ib. 947; Bank of Holly Springs *v.* Pinson, 58 Miss. 421; National Bank *v.* Dearborn, 115 Mass. 229; Stollenwerck *v.* Thatcher, Ib. 224; Corniek *v.* Richards, 3 Lea, 1; Cherry *v.* Frost, 7 Ib. 1; First Nat. Bank *v.* Bryce, 78 Ky. 42; Prall *v.* Tilt, 28 N. J. Eq. 483; Wood's App. 92 Pa. St. 379; Burton *v.* Patterson, 12 Phila. 397; Burton's App. 93 Pa. St. 214; Fraser *v.* Charleston, 11 S. C. 486; Merchants' Bank *v.* Richards, 6 Mo. App. 454; Ross *v.* Southwestern Ry. Co. 58

§ 264. THE CERTIFICATE OF STOCK.— A certificate of stock is a muniment of title; documentary evidence of the ownership of shares of the capital stock of the corporation issuing the same. By an indorsement in blank and delivery of the certificate, the shares of stock represented thereby become payable to bearer; the certificates may pass from one person to another like commercial paper so payable. The issue of such certificates, properly authenticated, is all that a corporation can do to show the interest of any person in its shares of stock. Such certificates are not shares of stock; and a title to shares may exist without a certificate.[1] Such certificates are a solemn affirmation under the seal of the company that a certain number of shares of the stock stand in the name of the individual mentioned in the certificate.[2] A share of stock itself is a species of incorporeal, intangible property, in the nature of a chose in action, which can never be realized except upon the dissolution and winding up of the corporation, and in the meantime entitles the holder to profits declared as dividends.[3] A certificate of stock may be the subject of pledge,[4] and the expression loan or discount on a

Geo. 514; Tiedeman *v.* Knox, 53 Md. 612; Holmes *v.* Bailey, 92 Pa. St. 57; Farmers' Bank *v.* Logan, 74 N. Y. 568; Becker *v.* Hallgarten, 86 Ib. 167; First Nat. Bank *v.* Northern R. R. Co. 58 N, H. 203; Security Bank *v.* Luttgren, 29 Minn. 363; Emery's Sons, *v.* Irving Nat. Bank, 25 Ohio St. 360; Cheever *v.* Meyer, 52 Vt. 66; Shropshire Unions Ry. Co. *v.* Queen, L. R. 7 H. L. 496; France *v.* Clark, L. R. 22 Ch. D. 830; Grissell *v.* Bristowe, L. R. 3 C. P. 112; Gurney *v.* Behrend, 3 El. & Bl. 633; Glyn, Mills & Co. *v.* East & W. India Docks Co. L. R. 7 App. 591.

[1] National Bank *v.* Watsontown Bank, 105 U. S. 17, 22; McAllister *v.* Kuhn, 96 U. S. 89; Hubbell *v.* Drexel, 11 Fed. Rep. 115; Beecher *v.* Wells etc. Co. 1 McCrary, 62; Cornick *v.* Richards, 3 Lea, 1; State *v.* North Louisiana & T. R. R. Co. 34 La. Ann. 947; White *v.* Salisbury, 33 Mo. 150; Agricultural Bank *v.* Burr, 11 Shepl. 263; Chester Glass Co. *v.* Dewey, 16 Mass. 94; Burrall *v.* Bushwick, 75 N. Y. 211, 216; Cheever *v.* Meyer, 52 Vt. 66; Strange *v.* Houston & T. Ry. Co. 53 Tex. 162.

[2] Shropshire Unions Rys. Co *v.* Queen, L. R. 7 H. L. 496 (Cairns, L. C.)

[3] Neiler *v.* Kelly, 69 Pa. St. 407; Cherry *v.* Frost, 7 Lea, 1; Cheever *v.* Meyer, 52 Vt. 66.

[4] Dayton Nat. Bank *v.* Merchants' Nat. Bank, 37 Ohio St. 208; Pinkerton *v.* Railroad Co. 42 N. H. 424; Colt *v.* Ives, 31 Conn. 25; Wilson *v.*

pledge of stock means that the stock of the person obtaining the loan is expressly and specifically pledged at the time for its repayment.[1]

§ 265. THE CERTIFICATE OF STOCK QUASI-NEGOTIABLE. —A certificate of stock, when indorsed with an irrevocable power of attorney to transfer, signed in blank by the owner, has a species of negotiability which is rather quasi-negotiable than actually negotiable. Under the enforcement of the rules of estoppel, such indorsements in blank render certificates of stock almost negotiable.[2] Certificates of stock bearing upon the face thereof the representation, under seal of the corporation issuing the same, that no transfer of the shares of stock represented thereby will be made except upon the surrender and cancellation of the certificate, is an intimation to all the world that such certificates are intended for circulation. Innocent persons advancing value upon such statements have an equitable claim that any loss resulting from

Little, 2 N. Y. 443; Cornick *v.* Richards, 3 Lea. 1; Conyngham's App. 57 Pa St. 474; Otis *v.* Gardner, 105 Ill. 436; Brewster *v.* Hartley, 37 Cal. 15; Mechanics' Bldg. Assn. *v.* Conover, 14 N. J. Eq. 219; Heath *v.* Silverthorne Co. 39 Wis. 147; Nisbit *v.* Macon Bank etc. Co. 12 Fed. Rep. 686. To an amount approximating their market value, with a reasonable margin for possible depreciation. Smith *v.* Crescent City Transfer Co. 30 La. Ann. 1378; Markham *v.* Jaudon, 41 N. Y. 235.

[1] Van Sands *v.* Middlesex County Bank, 26 Conn. 144, 157.

[2] Wood's App. 92 Pa. St 379; Finney's App. 56 Ib. 398; Burton's App. 93 Ib. 214; Biddle *v.* Bayard, 13 Ib. 150; Burton *v.* Patterson, 12 Phila. 397, 400; Matthew *v.* Bank, Holmes, 396; Continental Nat. Bank *v.* Eliot Nat. Bank, 7 Fed. Rep. 369, 372; Duke *v.* Cahawka Nav. Co. 10 Ala. 82; Ross *v.* Southwestern Ry. Co. 53 Geo. 514; N. Y. & N. H. R.R.Co. *v.* Schuyler, 34 N. Y. 30; McNeil *v.* Tenth Nat. Bank, 46 N. Y. 325; Fraser *v.* Charleston, 11 S. C. 486; Broadway Bank *v.* McElrath, 13 N. J. Eq. 24; Prall *v.* Tilt, 28 Ib. 483; Mount Holly Turnpike Co. *v.* Ferree, 17 Ib. 117; Tome *v.* Parkersburgh Ry. Co. 39 Md. 36; Atkinson *v.* Atkinson, 8 Allen, 15; Merchants' Bank *v.* Richards, 6 Mo. App. 454; Smith *v.* Crescent City Transfer Co. 30 La. Ann. 1378; Thompson *v.* Toland, 48 Cal. 99; Winter *v.* Belmont Mining Co. 53 Ib 428; Black *v.* Zacharie, 3 How. 483; Bank *v.* Lanier, 11 Wall. 369; Johnston *v.* Laflin, 103 U. S. 800.

giving credit thereto should fall on the company rather than on them.[1] Shares of stock or scrip made negotiable by indorsement by the terms thereof, or "cost-book" mining shares, are negotiable instruments.[2] In the absence, however, of any application of the rules of equitable estoppel, a certificate of stock, although indorsed in blank, and in the hands of an innocent indorsee for value advanced, is not a negotiable instrument within the meaning of the law merchant, and its indorsee is not charged with the duties and responsibilities nor does he enjoy all the privileges of a holder for value, without notice, of commercial paper.[3]

§ 266. And approximating to negotiable paper—Bank *v.* Lanier.—In the leading case of the First National Bank *v.* Lanier[4] decided by the Supreme Court of the United States, the nature and characteristics of certificates of stock were ably stated by the court (Davis, Jus.) The court say: "The power to transfer their stock is one of

[1] Willis *v.* Philadelphia Street Ry. Co. 13 Phila. 33.

[2] Jarvis *v.* Rogers, 13 Mass. 105; s. c. 15 Ib. 389; Walker *v.* Bartlett, 18 C. B. 845; Thompson *v.* Tolland, 48 Cal. 99.

[3] Mechanics' Bank *v.* N. Y. & N. H. Co. 13 N. Y. 599, 623; Weaver *v.* Barden, 49 Ib. 286; Stebbins *v.* Insurance Co. 3 Paige Ch. 350; Sewall *v.* Boston Water Power Co 4 Allen, 277, 282; Shaw *v.* Spencer, 100 Mass. 382, 388; Campbell *v.* Morgan, 4 Bradw. 100.

[4] 11 Wall. 377. A certificate of stock for 150 shares, which stated on its face that it was transferable "only upon the surrender of the certificate," was issued by a bank to A, who at the same time pledged the same to the bank as collateral security for deposits made with a firm of which A was a member. The pledgor, retaining the certificate, executed a separate power of attorney authorizing his attorney in fact to sell and transfer the stock in case the pledgee considered it necessary, and to appropriate the proceeds in payment of any balance due. The pledgor afterwards disposed of the certificate to Lanier and Handy for the full value thereof. Before the sale the bank had sold 50 of the shares, and before notice thereof sold all the shares, under the power of sale to innocent purchasers for value, to whom it issued new certificates. Two years after their purchase Lanier and Handy demanded transfer of the stock to their names, but the bank refused. The bank was mulcted in the damages.

the most valuable franchises conferred by Congress on banking associations. Without this power, it can readily be seen the value of the stock would be greatly lessened, and, obviously, whatever contributes to make the shares of the stock a safe mode of investment, and easily convertible, tends to enhance their value. It is no less the interest of the shareholder, than the public, that the certificate representing his stock should be in a form to secure public confidence, for without this he could not negotiate it to any advantage. It is in obedience to this requirement, that stock certificates of all kinds have been constructed in a way to invite the confidence of business men, so that they have become the basis of commercial transactions in all the large cities of the country, and are sold in open market the same as other securities. Although neither in form or character negotiable paper, they approximate to it as nearly as practicable. If we assume that the certificates in question are not different from those in general use by corporations, and the assumption is a safe one, it is easy to see why investments of this character are sought after and relied upon. No better form could be adopted to assure the purchaser that he can buy with safety. He is told, under the seal of the corporation, that the shareholder is entitled to so much stock, which can be transferred on the books of the corporation, in person or by attorney, when the certificates are surrendered, but not otherwise. This is a notification to all persons interested to know, that whoever in good faith buys the stock, and produces to the corporation the certificates, regularly assigned, with power to transfer, is entitled to have the stock transferred to him. And the notification goes further, for it assures the holder that the corporation will not transfer the stock to any one not in possession of the certificates."

§ 267. Indorsements in blank of Stock Certificates.—A transfer of shares of stock in a corporation by the delivery of the certificate, with an irrevocable power of

attorney to transfer in blank indorsed and signed by the owner, vests the legal and equitable title thereto in the innocent holder for value without notice, and such certificate may pass from hand to hand.[1] Nor is a seal necessary to authorize a transfer, in the absence of some statutory requirement for its use.[2] Even when the indorsement in blank is made under seal, the blanks may be filled up in accordance with the agreement of the parties at the time.[3] No constructive notice of any equities of third persons is charged as against a pledgee for value of a certificate of stock, from the fact that it shows upon its face that it was issued to another person than the pledgor and that the indorsement thereof is in blank.[4]

Considering the effect of negotiating a certificate of stock indorsed in blank, in Johnston *v.* Laflin,[5] the United

[1] Carroll *v.* Mullanphy Savings Bank, 8 Mo. App. 249; Matthews *v.* Bank, Holmes, 396; Mount Holly Co. *v.* Ferree, 17 N. J. Eq. 117; R. R. Co. *v.* Bank, 30 Conn. 273; Kortright *v.* Bank, 20 Wend. 91; s. c. 22 Ib. 348; Leavitt *v.* Fisher, 4 Duer, 1; R. R. Co. *v.* Selinger, 34 N. Y. 45; McNeil *v.* Bank, 46 Ib. 325; Cutting *v.* Damerel, 88 Ib. 410; Leitch *v.* Wells, 48 Ib. 613; German Union Bldg. Assn. *v.* Sendmeyer, 50 Pa. St. 67; Otis *v.* Gardner, 105 Ill. 536; Day *v.* Holmes, 103 Mass. 306; Cornick *v.* Richards, 3 Lea, 1; Cherry *v.* Frost, 7 Ib. 1.

[2] Kortright *v.* Buffalo Bank, 20 Wend. 91; s. c. 22 Ib. 348.

[3] Matthews *v.* National Bank, supra; Bridgeport Bank *v.* N. Y. & N. H. R. R. Co. 30 Conn. 274, 5.

[4] Burton *v.* Peterson, 12 Phila 397.

[5] 103 U. S. 800. Laflin sold his stock in a bank to a broker, indorsing the certificates in blank; the broker sold them to B. who was the president of the bank, issuing the stock, receiving his individual check, and delivering the certificate. Immediately after the transaction B. caused his check to be charged against the bank, and entered his name on the stock book as "trustee of the bank." The bank subsequently failed, and a receiver was appointed, who sought unsuccessfully to compel B. to re-convey the shares, and that Laflin should repay the price, and be declared to be a stockholder. Laflin was free from fraud in the transaction. The court add: "It would be a perversion of justice and of the ordinary rules governing men in commercial transactions to hold the sale, under such circumstances, vitiated by the relation of the purchaser to others, of which the seller had no knowledge, or any grounds to entertain a suspicion. The validity of the sale of stock can not be

States Supreme Court (Field, Jus.) say: "The transferability of shares in the national banks is not governed by different rules from those which are ordinarily applied to the transfer of shares in other corporate bodies. The power of attorney indorsed on the certificate is usually written or printed, with a space in blank for the name of the attorney to be inserted, for the accommodation of the purchaser. The subsequent filling up of the blank by him with another name, instead of his own, as it may suit his convenience, does not so connect the vendor with the party named as to charge him with the latter's knowledge and thus affect the previous transaction. A different doctrine would put a speedy end to the signing of powers of attorney in blank. And instruments of that kind are of great convenience in the sale of shares of incorporated companies, and are in constant use. The name with which the blank may be subsequently filled up by the purchaser is not, in practice, regarded as affecting the previous sale in any respect, but as a matter which concerns only the purchaser. It would be a source of disturbance in business if any other result were attached by the law to the proceeding."

§ 268. Blank transfers of Stock Certificates in England.—The validity of transfers of stock indorsed in blank was recognized in England in an early case.[1] The rule in that country is, that where an owner of shares of stock obtains a loan of money depositing with the lender certificates of his shares, together with transfers thereof signed by him, but with the date and name of the transferee in blank, an implied authority is given the pledgee

made to depend upon the accident of the immediate purchaser, or of the party to whom he may transfer the certificate, in filling up the blank in the power of attorney with the name of the person, to make the formal transfer, who is acquainted with the secret interests of others in the shares purchased. The validity of a sale and its completeness must be determined by the relation which the contracting parties at the time openly bear to each other."

[1] Walker *v.* Bartlett, 15 C. B. 845.

to fill up such blanks so that he may be able to make his security effective. Such transfers in blank pass the legal interest in the shares, if the articles of association do not require a deed.[1] The availability of a blank indorsement of a certificate of stock to pass the legal title thereto is not restricted to the first pledge thereof. Under such blank indorsement a sub-pledgee may fill in such blanks and obtain new certificates.[2] Where, however, the transfer of the certificates to a sub-pledgee, although with blank indorsement, is not complete so as to vest the legal title until after notice of the rights of the owner, the sub-pledgee is not entitled to a transfer, although his equitable interest is protected to the amount of the original loan.[3]

[1] Evans *v.* Wood, L. R. 5 Eq. 539; in re Tahiti Cotton Co. 17 Ib. 273; Paine *v.* Hutchinson, L. R. 3 Eq. 557; s. c. 3 Ch. 388; Grissell *v.* Bristowe, L. R. 3 C. P. 112; Hawkins *v.* Matly, L. R. 4 Ch. 200; Coles *v.* Bristowe, Ib. 3, 13.

[2] In re Tahiti Cotton Co. L. R. 17 Ib. 539.

[3] France *v.* Clark, L. R. 22 Ch. D. 830; aff. by the Court of Appeal (Earl Selborne, L. C.) 26 Ib. 257.

CHAPTER XXVII.

THE PLEDGEE OF STOCK A HOLDER FOR VALUE.

§269. The pledgee of certificates of stock indorsed a holder for value.
270. Title of innocent holder for value unimpeachable.
271. The pledgee's demand for transfer by the corporation
272. The transfer of stock certificates, as between pledgor and pledgee.
273. Transfer of stock on the books of the corporation.
274. Limitations of company's right to control transfer.
275. Transfer, as controlled by the terms of certificate.
276. The pledge of stock by delivery.
277. The pledge by delivery merely, subject to equities.
278. Pledgees of stock not affected by insolvency of pledgor.
279. Pledges of stock for antecedent debt and future advances.
280. The pledgee of stock certificates entitled to dividends.
281. Pledgee of stock entitled to protect the corporation's property.

§269. THE PLEDGEE OF CERTIFICATES OF STOCK INDORSED, A HOLDER FOR VALUE.—The pledgee of certificates of stock, receiving the same indorsed, with an irrevocable power of attorney to transfer, in good faith, without notice, and for value advanced thereon, is entitled to the privileges of a bona fide purchaser for value, in the usual course of business. Such indorsement and delivery of certificates of stock as collateral security vests the legal and equitable title in the pledgee and he holds the absolute ownership of the shares of stock represented thereby. His title, when he has advanced value in good faith, without notice, cannot be impeached, although the act of pledge be a fraud and misappropriation of such certificates of stock by persons entrusted therewith so as to have the apparent ownership.[1]

[1] Otis *v.* Gardner, 105 Ill. 436; Baldwin *v.* Canfield, 26 Minn. 43; Carroll *v.* Mullanphy Banking Co. 8 Mo. App. 249; First Nat. Bank *v.*

The title thus acquired by an innocent pledgee for value of stock collaterals is sustained as between the parties, and (in the absence of restrictive statutory or charter provisions) as against the company and third parties seeking by legal process to subject such shares of stock to the payments of debts or other liabilities of the pledgor, although no transfer thereof has been made on the books of the company issuing the same, or notice given.[1]

§ 270. Title of Innocent Holder for Value unimpeachable.—It is established by commercial usage that a certificate of stock indorsed with an irrevocable power of attorney in blank or filled up, is, in the hands of a third person, presumptive evidence of ownership of the holder. The title of an innocent holder for value, and in the usual course of business, having possession of the certificate, indorsed to himself or in blank, is good against the world. Subsequent purchasers of such certificates, although paying value, but not receiving the certificates; the company issuing the stock, when a transfer is demanded by such holder for value without notice; and creditors of the pledgor and transferrer, are not allowed to impeach the title of such innocent holder for value.[2] The transfer of certificates of stock, in-

Hartford Ins. Co. 45 Conn. 22; Cornick *v.* Richards, 3 Lea, 1; Cherry *v.* Frost, 7 Ib. 1; Fraser *v.* Charleston, 11 S. C. 486; ex parte Bank of Manchester, L. R. 12 Eq. 354; Fraser *v.* Charleston, 11 S. C. 486; Cheever *v.* Meyer, 52 Vt. 66; ex parte Sargeant, L. R. 17 Eq. 273; ex parte Agra Bank, L. R. 3 Ch. 555.

[1] National Bank *v.* Watsontown Bank, 105 U. S. 217, 222; Johnston *v.* Laflin, 103 U. S. 800; Hasbrouck *v.* Vandervoort, 4 Sandf. 74; Finney's App. 59 Pa. St. 398; Fraser *v.* Charleston, 11 S. C. 486; Merchants' Nat. Bank *v.* Richards, 6 Mo. App. 454; Cornick *v.* Richards, 3 Lea, 1.

[2] Johnston *v.* Laflin, 103 U. S. 800; Webster *v.* Upton, 91 U. S. 65; Bank *v.* Lanier, 11 Wall. 369; Dovey's App. 97 Pa. St. 53; Wood's App. 92 Ib. 379; Kortright *v.* Commercial Bank, 20 Wend. 91; Fatman *v.* Loback, 1 Duer, 354, 361; McNeil *v.* Tenth Nat. Bank, 46 N. Y. 325; Bank of Utica *v* Smalley, 2 Cowen, 770; Mount Holly Turnpike Co. *v.* Ferree, 17 N. J. Eq. 117; Prall *v.* Tilt, 28 Ib. 480; Bridgeport Bank *v.* N. Y. & N. H. Ry. Co. 30 Conn. 275, Sergeant *v.* Franklin Ins. Co. 8 Pick.

dorsed, under the general usage of dealers in securities and on exchanges, vests in the holder for value, without notice, more than the mere equitable title obtained upon the assignment and delivery of a non-negotiable chose in action. The legal ownership vests in the indorsee of a stock certificate, indorsed in blank, as in the case of the favored instruments of commerce. Nor will the transfer be "burdened with the shackles imposed by a lis pendens."[1]

§ 271. THE TRANSFER OF STOCK CERTIFICATES, AS BETWEEN PLEDGOR AND PLEDGEE.—As between the parties to the contract of pledge, the delivery of a certificate of stock, indorsed by the owner with an irrevocable power of attorney to transfer in blank, vests in the pledgee, upon a bona fide advance, the legal title to the shares of stock represented by the certificate, although no notice is given to the corporation issuing the certificate, nor transfer obtained upon its books. It is enough, as between the parties, that the certificate is delivered with authority to the holder, or any one he may name, to transfer it upon the books of the company, the consideration for the indorsement and delivery of the certificate being advanced in good faith.[2] The rule is not

90; Moodie *v.* Nat. Bank, 11 Phila. 366; Fraser *v.* Charleston, 11 S. C. 486; Bank *v.* Campbell, 2 Rich. Eq. 179; Continental Bank *v.* Bank, 7 Fed Rep. 369.

[1] Cutting *v.* Damerel, 88 N. Y. 410; Leitch *v.* Wells, 48 Ib. 585. In Dovey's App., 97 Pa St. 153, the Pennsylvania court cite the New York cases as to *lis pendens* applying to the transfer of stock, but decide the case upon other grounds.

[2] Johnston *v.* Laflin, 103 U. S. 800; Bank *v.* Bank, 105 Ib. 217; McAllister *v.* Kuhns, 96 Ib. 87; Webster *v.* Upton, 91 Ib. 65; Bank *v.* Lanier, 11 Wall. 369; Holbrook *v.* New Jersey Zinc Co. 57 N. Y. 616; Driscoll *v.* W. B. & C. M. Co. 59 Ib. 96, 101; McNeil *v.* Tenth Nat. Bank, 46 Ib. 331; Leitch *v.* Wells, 48 Ib. 592; N. Y. & N. H. R. R. Co. *v.* Schuyler, 34 Ib. 30; Johnson *v.* Underhill, 52 Ib. 503; Cushman *v.* Thayer Manuf. Co. 76 Ib. 365; Cutting *v.* Damerel, 88 Ib. 410; Commercial Bank *v.* Kortright, 20 Wend. 91; s. c. 22 Ib 362; Smith *v.* Crescent City Transfer Co. 30 La. Ann. 1378; Sibley *v.* Quinsigamond Bank, 133 Mass. 515; Cornick *v.* Richards, 3 Lea, 1; Cherry *v.* Frost, 7 Ib. 1; Broadway Bank *v.* McElrath, 13 N. J. Eq. 26; Turnpike Co. *v.* Ferree, 17 Ib. 118; Hunterdon *v.* Nassau Bank, Ib. 496; Rogers *v.* Stevens, 8 Ib. 167; Moore *v.* Bank,

questioned in any jurisdiction that, as between the parties to the contract of pledge, when made upon a bona fide advance actually paid, the indorsement and delivery of certificates of stock convey to the pledgee if not the legal yet an equitable title to the property in the shares represented thereby. Under this latter view, however, the pledgee receiving only an equitable title, although advancing money upon the credit of the certificates, is subject, where no transfer of the stock has been obtained upon the books of the company, to the claims of creditors levying upon the stock, although they may have received some of the funds advanced by the pledgee, and probably allowed the debts of the pledgor to be incurred in ignorance of the ownership of the stock. The limited rule should be restricted to cases where the statutory or charter enactments make transfer upon the books of the company essential, and are supplemented by other legislation giving to creditors such right of levy upon shares of stock of debtors.[1]

In Johnston *v.* Laflin,[2] the court (Field, Jus.), considering the effects of transfer of stock certificates indorsed in

52 Mo. 377; Carroll *v.* Mullanphy Savings Bank, 8 Mo. App. 249; s. c. aff. 74 Mo. 77; Sergeant *v.* Franklin Ins. Co. 8 Pick. 90; Strange *v.* Houston & T. C. Ry. Co. 53 Tex. 162; Railroad Co. *v.* Thomasson, 40 Ga. 411; Dovey's App. 97 Pa. St. 153; Lightner's App. 82 Pa St. 301; German etc. Bank *v.* Sendmeyer, 50 Ib. 67; Commonwealth of Pennsylvania *v.* Watmough, 6 Whart. 138; Duke *v.* Cahawba Nav. Co. 10 Ala. 82; Bank of Commerce's App. 73 Pa. St. 59; Pittsburgh Ry. Co. *v.* Clarke, 29 Ib. 146; Gilbert *v.* Manchester Iron Co. 11 Wend. 628; Bank of Utica *v.* Smalley, 2 Cowen, 777.

[1] Sibley *v.* Quinsigamond Bank, 133 Mass. 515; Fisher *v.* Essex Bank, 5 Gray, 373; Blanchard *v.* Dedham Gas Co. 12 Ib. 213; Pinkerton *v.* R. R. Co. 42 N. H. 424; Skowhegan Bank *v.* Cutter, 49 Me. 315; Agricultural Bank *v.* Burr, 24 Ib. 256; Lightner's App. 82 Pa. St. 301; Pittsburgh etc. Ry. Co. *v.* Clarke, 29 Ib. 146; Bank of Commerce's App. 73 Ib. 59; Beecher *v.* Wells etc. Co. 1 McCrary C. C. 62; Union Bank *v.* Laird, 2 Wheat. 390; Black *v.* Zacharie, 3 How. 483; People's Bank *v.* Gridley, 91 Ill. 459; Kellogg *v.* Stockwell, 75 Ib. 68; Laing *v.* Burley, 101 Ill. 591; Otis *v.* Gardner, 105 Ib. 436; Lockwood *v.* Mechanics' Nat. Bank, 9 R. I. 308; Conant *v.* Seneca County Bank, 1 Ohio St. 298; Cheever *v.* Meyer, 52 Vt. 66; Sabin *v.* Bank, 21 Ib 353.

[2] 103 U. S. 800, 803.

blank, as between the parties, say: "The sale was consummated, so far as Laflin was concerned, when he delivered the certificate, with the power to transfer it, to the broker. The latter did not mention the name of the principal for whom he was acting. He declined to give it. Laflin had a right, therefore, to treat him as the principal, and if he was competent to make the purchase the sale was valid. Shares in the capital stock of associations, under the national banking law, are salable and transferable at the will of the owner. They are, in that respect, like other personal property. The statute recognizes this transferability, although it authorizes every association to prescribe the manner of their transfer. * * * As between Laflin and the broker, the transaction was consummated when the certificate was delivered to the latter, with the blank power of attorney indorsed, and the money was received from him. As between them, the title to the shares then passed; whether that be deemed a legal or equitable one matters not; the right to the shares then vested in the purchaser."[1] In the case of National Bank *v.* Watsontown Bank, the court, again describing the effect of a transfer of stock, as between the parties to a contract of pledge, say (Matthews, Jus.): "As between Powell & Co. [the pledgors], and Tome, representing the appellants [the pledgees], the property in the shares of stock, undoubtedly, passed to the latter without the formality of a transfer on the books of the Watsontown Bank. As collateral security for the payment of their notes, discounted and held by the Cecil National bank, and with the power to sell for the purpose of payment, the title passed by the delivery of the certificate, with the accompanying power of attorney."[2]

§ 272. THE PLEDGEE'S DEMAND FOR TRANSFER BY THE CORPORATION.—The delivery of certificates of stock as collateral security with a power of attorney to transfer them to

[1] 105 U. S. 217, 220.

[2] Citing Johnston *v.* Laflin, 103 U. S. 800.

another person, confers a power coupled with an interest, and gives to any one claiming under an execution of the power a right to demand of the company new certificates of stock. The power thus given can only be revoked by payment of the debt, for which the stock has been transferred as collateral security.[1] The pledgee of a certificate of stock in Massachusetts, while restricted by statute in his rights under a contract of pledge, so that he can not sell, lend, or pledge the stock certificates held by him as collateral security, is still entitled to require a new certificate to be issued to himself or a third person. The title of the stock thus obtained is held subject to the agreement of pledge, but is permitted in order to render the collateral securities more available to the pledgee.[2] Upon the refusal of a corporation to make such transfer, upon demand and presentation of a certificate, with irrevocable power of attorney to transfer indorsed thereon, the holder for value may bring an action at law against the corporation for damages, recovering the actual value of the stock at the time of the refusal to transfer, or resort may be had to equity to require a transfer to be made, or to afford other suitable relief.[3] A petition for a writ of mandamus to compel the corporation to make the transfer is, it seems, appropriate.[4]

[1] Dickinson *v.* Cent. Nat. Bank, 129 Mass. 279; Rich *v.* Noble, 39 Md. 314; Hunt *v.* Rousmanier, 8 Wheat. 174; Gill *v.* Continental Gas Co. L. R. 7 Ex. 332; Simm *v.* Anglo-American Tel. Co., L. R. 5 Q. B. D. 188, 215.

[2] Fay *v.* Gray, 124 Mass. 500.

[3] Case *v.* Bank, 100 U. S. 446; Johnston *v.* Laflin, 103 Ib. 800; McAllister *v.* Kuhn, 96 Ib. 87; National Bank *v.* Bank, 10 Bush, 367; Bank *v.* McNeil, Ib. 56; Dayton Nat. Bank *v.* Bank, 37 Ohio St. 208, 215; German Union Bldg Assn. *v.* Sendmeyer, 50 Pa. St. 67; Hill *v.* Pine River Bank, 45 N. H. 300; Railroad Co. *v.* Sewall, 35 Md. 239; Fraser *v.* Charleston, 11 S. C. 486; Bond *v.* Mount Hope Co. 99 Mass. 506; Sargent *v.* Franklin Ins. Co. 8 Pick. 100; Gray *v.* Portland Bank, 3 Mass. 364; Kortright *v.* Buffalo Bank, 20 Wend. 91; Bank of Attica *v.* Bank, 20 N. Y. 505; Gill *v.* Continental Gas Co. L. R. 7 Ex. 332.

[4] Campbell *v.* Morgan, 4 Bradw. 100, 105; Shropshire Unions Ry. Co. *v.* Queen, L. R. 7 H. L. 420.

§ 273. Transfer of Stock on the books of the Corporation.—In cases where a pledgee for value of stock certificates has neglected to obtain, in compliance with statutory or charter provisions, a transfer of the shares upon the books of the company and the issue of new certificates, he receives an equitable title only and is subject to the equities of third parties.[1] Under such statutory or charter enactments, no person can acquire a legal title to the shares of stock, except upon a regular transfer thereof into his name upon the books of the company, and the issue of new certificates. The equities to which he is subject, while holding what is regarded as an equitable title simply, include any liens of the corporation itself, of which he is presumptively chargeable with notice.[2] All that is necessary where the transfer is required by law to be made upon the books of a corporation, is that the fact itself should be appropriately recorded in some one or other of such books. An entry in a stock ledger, showing a debit and credit charge

[1] Fisher *v.* Essex Bank, 5 Gray, 373; Rock *v.* Nicholls, 3 Allen, 343; Union Bank *v.* Laird, 2 Wheat. 390; Oxford Bank *v.* Bunnel, 6 Conn. 558; Dalton *v.* Connecticut Bank, 13 Ib. 493; Shipman *v.* Etna Ins. Co. 29 Ib. 245; Weston *v.* Bear River etc. Co. 5 Cal. 186; Straut *v.* Natoma Co. 9 Ib. 78; Naglee *v.* Pacific Wharf Co., 20 Ib. 529; Winter *v.* Belmont Mining Co. 53 Ib. 431; People's Bank *v.* Gridley, 91 Ill. 467; Fiske *v.* Carr, 20 Me. 301; Skowhegan Bank *v.* Cutler, 49 Ib. 315; Pinkerton *v.* Railroad Co. 42 N. H. 424; Bank of Commerce's App. 73 Pa. St. 59; Robert's App. 85 Ib. 84; Cheever *v.* Meyer, 52 Vt. 66; Sabin *v.* Bank, 21 Ib. 353; in re Murphy, 51 Wis. 519. In Cheever *v.* Meyer, supra, the court say: "A sale of the stock, with a transfer of the certificate indorsed with a power of attorney to the purchaser to make the necessary transfer on the books of the corporation, transfers to the purchaser the equitable interest and legal right of the vendor in the property evidenced by the certificate assigned. It completes the transaction between the vendor and the purchaser. But as regards the corporation and those who have a right to look to its records for the owners of the stock, the transaction is incomplete. The purchaser does not become vested with the absolute title to the stock—does not become a stockholder in the corporation—until the purchased stock is transferred to him on the books of the corporation."

[2] Union Bank *v.* Laird, 2 Wheat. 390; Bank of Commerce's App. 73 Pa. St. 59.

between the two parties, pledgor and pledgee, is a sufficient compliance with such statute, and vests the transferee with a complete and absolute title, and, so far as the corporation is concerned, the act is irrevocable.[1] Or a notice at a meeting of the board of directors of the company is sufficient.[2] Statutory provisions, requiring transfer on the books of the company, are intended chiefly for the benefit of the company.[3] The single consideration that a creditor of a shareholder in a national bank has no right of access to the books of the bank, and no means of obtaining knowledge of transfers upon them, shows that such record is not intended for his benefit.[4] Possession of the certificate, with authority to transfer, is prima facie sufficient to require the corporation issuing the same to extend to the holder the privileges and benefits to which the person in whose name such certificate was originally issued, was entitled.[5] Application for transfer, however, without production of the certificate, is *per se* notice to a company, through its officers, that the legal title to the shares of stock represented thereby may be in a third person, a holder for value, without notice.[6]

Transfer of the shares into the name of the transferee is necessary, in England, to pass the legal title, and perhaps such transfer should be registered, which is generally done.[7]

[1] National Bank *v.* Watsontown Bank. 105 U. S. 217.

[2] Ex parte Agra Bank, L. R. 3 Ch. 555.

[3] Strange *v.* Houston etc. Ry. Co. 53 Tex. 162; Sergeant *v.* Essex Marine Ry. 9 Pick. 201; Bank *v.* Kortright, 22 Wend. 362; Bank of Utica *v.* Smalley, 2 Cow. 770; Ins. Co. *v.* Goodfellow. 9 Mo. 150; Chouteau Springs Co. *v.* Harris, 20 Ib. 382; Kellogg *v.* Stockwell, 75 Ill. 68; Broadway Bank *v.* McElrath, 13 N. J. Eq. 26; Continental Bank *v.* Eliot Bank, 7 Fed.Rep. 369.

[4] Sibley *v.* Quinsigamond Bank, 133 Mass. 515.

[5] Strange *v.* Houston & T. Ry. Co. 53 Tex. 162.

[6] Strange *v.* Houston & T. Ry. Co 53 Tex. 162; New York & N.H. R. R. Co. *v.* Schuyler, 34 N. Y. 81; Brisbane *v.* Railroad Co. 25 Hun, 438; Bayard *v.* Bank, 52 Pa. St. 235; Holbrook *v.* New Jersey Zinc Works, 57 N. Y. 616.

[7] Shropshire Unions Ry. Co. *v.* Queen, L. R. 7 H. L. 496.

The legal title to shares of stock can only be obtained by an instrument executed in the manner required by the articles of association.[1] A mere delivery of certificates of stock without the legal title thereto, is not sufficient to protect the interests of the pledgee as against third parties.[2] Where, however, the legal title to shares of stock is vested in a mortgagee or pledgee, an equity of redemption merely remaining in the mortgagor or pledgor, the right to a transfer of the stock as against the mortgagor or pledgor, and to compel the company to register such transfer, is enforced by courts of equity.[3]

§ 274. Limitations of Company's right to control transfer.—The directors of a company, however, have no discretionary power independently of authority given by the charter or articles of association, to refuse the registry of a transfer which has been properly made and in good faith.[4] And the terms of transfer prescribed under statutory or charter powers are required to be reasonable. As said by the United States Supreme Court, (Field, Jus.) in a recent case:[5] The power of corporations "in that respect, however, can only go to the extent of prescribing conditions essential to the protection of the association against fraudulent transfers, or such as may be designed to evade the just responsibility of the stockholder. It is to be exercised reasonably. Under the pretence of prescribing the manner

[1] Simm *v.* Anglo-Am. Tel. Co. L. R. 5 Q. B. D. 216.

[2] Shropshire Unions Ry. Co. *v.* Queen, supra.

[3] Gill *v.* Continental Gas Co. L. R. 7 Ex. 332.

[4] Weston's case, L. R. 4 Ch. 20. Sir W. Page Wood (L. J.) in delivering judgment, said (p. 27): "Many persons enter these companies for the very reason that they are not like ordinary partnerships, but that they are partnerships from which members can retire at once, and free themselves from responsibility at any time they please, by going into the market and disposing of and transferring their shares without the consent of the directors or shareholders, or anybody, provided it is a bona fide transaction, and out and out."

[5] Johnston *v.* Laflin, 103 U. S. 800, 804.

of the transfer, the association cannot clog the transfer with useless restrictions, or make it dependent upon the consent of the directors or other stockholders. It is not necessary, however, to consider what restrictions would be within its power, for it had imposed none. The entry of the transaction on the books of the bank, where stock is sold, is required, not for the translation of the title, but for the protection of the parties and others dealing with the bank, and to enable it to know who are its stockholders, entitled to vote at their meetings and receive dividends when declared. It is necessary to protect the seller against subsequent liability as a stockholder, and perhaps also to protect the purchaser against proceedings of the seller's creditors. Purchasers and creditors, in the absence of other knowledge, are only bound to look to the books of registry of the bank."

§ 275. TRANSFER, AS CONTROLLED BY TERMS OF CERTIFICATE.—The terms in which certificates of stock are issued by a corporation is a material consideration upon the question of transfer. A company is bound by the representations it makes, generally under seal, on the face of its certificates, and third persons advancing money upon the credit of such statements, are entitled to rely thereon. Where they set forth the manner of transfer of such stock, they constitute the regulations thereof.[1] Nor is the holder for value, without notice, of such certificate required to examine and ascertain at his peril whether previous transfers thereof were valid.[2] Nor, in the absence of any requirement upon the certificate itself, is the holder thereof for value, without

[1] Bank of Holly Springs *v.* Pinson, 58 Miss. 421, 437; Bank *v.* Lanier, 11 Wall. 369; Van Sands *v.* Middlesex Bank, 26 Conn. 144; Townsend *v.* McIver, 2 Rich. 43; Williams *v.* Mechanics' Bank, 5 Blatchf. 50; People's Bank *v.* Gridley, 91 Ill. 457. As to the clause "transferable only on the books of the company," it is discussed in Fisher *v.* Essex Bank, 5 Gray, 373, by Gray, C. J.; in Cheever *v.* Meyer, 52 Vt. 66; Williams *v.* Mechanics' Bank, 5 Blatchf. 59, and a strict construction given thereto.

[2] Lowry *v.* Bank, Taney, 310; Salisbury Mills *v.* Townsend, 109 Mass. 115.

notice, required to give notice to the company of its indorsement and delivery, where the certificate declares that transfer will be made only upon the surrender thereof.[1] The title of a holder for value, without notice, of a certificate of stock making such representations, is not affected by a by-law of the corporation providing for the assignment of such shares by a separate instrument. The company is estopped as against an innocent holder for value of a certificate, indorsed with irrevocable authority to transfer, to deny that it has the stock when transfer thereof is demanded. It is no defense for the company that other certificates have been issued upon an assignment executed separately, the certificates not having been produced and surrendered.[2]

The rule was enforced where a pledge of certificates of stock, transferable "only upon the surrender of this certificate," was made to a bank to secure deposits made with another bank, by a separate, independent instrument, authorising the sale thereof upon default, the certificates not being delivered. The stock certificates were subsequently negotiated by the pledgor to a bona fide holder for value without notice, the certificates being indorsed and delivered. Notice was given to the bank, but prior thereto, all the shares had been sold under the power of attorney. Transfer having been refused, the bona fide holder for value, without notice, advancing his money upon the faith of the representations contained in such certificates, was allowed to recover his damages from the bank.[3]

[1] Bank *v.* Lanier, 11 Wall. 369.

[2] Strange *v.* Houston etc. Ry. Co. 53 Tex. 162; Holbrook *v.* Zinc Co. 57 N. Y. 616; McNeil *v.* Tenth Nat. Bank, 46 Ib. 331; in re Bahia & S. F. Ry. Co. L. R. 3 Q. B. 584.

[3] First National Bank *v.* Lanier, 11 Wall. 369. The court (Davis, Jus.) say: "In this case Lanier and Handy made their purchase of Culver. They bought for value, without knowledge of any adverse claim, in full faith that the bank would observe its engagements, and pursued in all respects the directions given in the certificates. They were not told to give notice to the bank of their purchase, nor was there any necessity for notice, because, by the rules of the bank, Culver could not transfer the stock in the absence of the certificates, and these they had

§ 276. THE PLEDGE OF CERTIFICATES OF STOCK BY DELIVERY.—The use of certificates of stock as collateral security where made by a mere delivery of the certificates without any power of transfer properly signed, vests in the pledgee an equitable title only. The pledgee is unable to enforce his security, upon default, by the ordinary processes of sale; but he may obtain relief in equity, where the performance of the necessary acts to render the security available may be decreed.[1] Relief was given in equity where certificates of stock had been pledged, and it was not discovered until after maturity of the principal note and default, that the power of attorney to transfer such certificates had not been signed by the pledgor. The pledgee was allowed, either to have the necessary indorsement made or to sell the certificates and apply the proceeds to the discharge of the note.[2] A mere executory contract for the transfer of stock as collateral security is not enforced in equity to the prejudice of third persons who have acquired rights therein bona fide.[3] Nor to the injury of a pledgee of the same shares of stock, advancing money in good faith, without notice, of the previous pledge, who has obtained an actual transfer of the shares to his own name on the books of the company.[4] Under the Louisiana code and judicial decisions

in their possession. It is therefore clear, in making their purchase of Culver, that they had a right to rely on the certificates as securing to them the stock which they represented. And it is equally clear that the bank in allowing this stock to be transferred to other parties, while the certificates were outstanding in the hands of bona fide holders, was guilty of a breach of corporate duty, and as its conduct operated to the injury of Lanier and Handy, an action will lie in their behalf to obtain satisfaction for the injury." Citing Bridgeport Bank *v.* N. Y. & N. H. R. R. Co. 30 Conn 270; N. Y. & N. H. R.R. Co. *v.* Schuyler, 34 N. Y. 30.

[1] Nesbit *v.* Macon Bank etc. Co. 12 Fed. Rep 686; Johnston *v.* Dexter, 2 MacAr. 530; Allen *v.* Dykers, 3 Hill, 593; s. c. 7 Ib. 497; Wilson *v.* Little, 2 N. Y. 443; Newton *v.* Fay, 10 Allen, 505; ex parte Boulton, 1 DeG. & J. 163.

[2] Johnson *v.* Dexter, 2 MacAr. 530.

[3] State Fire Ins. Co. *v.* Olmstead, 33 Conn. 480.

[4] Platt *v.* Hawkins, 43 Conn. 139; Platt *v.* Birmingham Axle Co. 41 Ib. 255.

shares of stock may be pledged by contract and delivery of the certificates. Such certificates are taken by the pledgee subject to all the liens and privileges which the law places upon them.[1] Possession of the stock certificates, however, may be held by one occupying *ad hoc* the position of a trustee. The debtor himself may in some cases be considered as such trustee, and be given possession, provided his tenure is precarious and clearly for account of the creditor.[2]

§ 277. THE PLEDGEE BY DELIVERY MERELY, SUBJECT TO EQUITIES.—A pledgee of certificates of stock, by mere delivery or an equitable mortgage thereof, is subject to the equities of third persons and cestuis que trust, although he may have a written agreement from the pledgor to execute a legal transfer of the shares. The rule thus limiting the rights of a pledgee by delivery was enforced in a case where the act of pledge of the stock was a fraudulent misappropriation The pledgee's only way, in the opinion of the English House of Lords, of making himself safe was by finding out if the person whose name was on the register was a trustee, and if so, by getting from the person for whom he was a trustee a declaration that his interest had ceased, or else by acquiring the legal title, and so placing himself in a better position than those who were trying to rest upon an equitable title.[3] Although the trustee held the legal title and the right to transfer the stock and to give a valid receipt for the purchase-money to any innocent person

[1] Smith *v.* Slaughter-house, 30 La. Ann. 1378; N. O. Banking Assn. *v.* Wiltz, 10 Fed. Rep. 330; Blouin *v.* Hart, 30 La. Ann. 714; Factor's Ins. Co. *v.* Drydock, 31 Ib. 145; Succ. Rossean, 23 La. Ann. 3; Hoss *v.* Williams, 24 Ib. 568.

[2] Conger *v.* City of New Orleans, 32 La. Ann 1250; James *v.* Pike, 23 Ib. 478; Lallande *v.* Ingram, 19 Ib. 364; Succ. D'Meza, 26 Ib. 35; Blouin *v.* Hart, 30 Ib. 714; Smith *v.* Slaughter-house, Ib 1378; Banking Assn. *v.* Wiltz, 10 Fed. Rep 330; La. Rev. C. Code, 3158. And the same rule prevails under the Roman and French law. Pothier, Pand. v. vii, p. 360; Pothier, Nant. 8; Troplong, Nant. Nos. 97-99; 309 312.

[3] Shropshire Unions Ry. Co *v.* Queen, L. R. 7 H. L. 496, 513 (Hatherly, Lord).

without knowledge of the trust, yet where the title acquired was only equitable, it was necessarily imperfect, and would not bind the real beneficial owner. The pledgee should have taken the pledgor at his word, for all he had to do was by the most simple means, to take the pledgor, or a written authority from him, to the company, and demand a transfer of the shares. If the company (the cestui que trust in the case) had made the transfer, the pledgee would have had an unimpeachable legal title to the shares, as a pre-existing equitable title may be defeated by a supervening legal title obtained by transfer; and such cestuis que trust may be estopped by conduct, representations or mis-statements. To have this result, that which is relied upon for such a purpose must be shown and proved by those upon whom the burden to show and prove it lies, and it must amount to something tangible and distinct, something which can have the grave and strong effect to accomplish the purpose for which it is said to have been produced.[1]

§ 278. Pledgees of Stock not affected by insolvency of Pledgor.—The subsequent insolvency or bankruptcy of the pledgor, where the certificates of shares of stock pledged as collateral security have passed with full title to the pledgee, and with transfer on the books of the company where required by statutory enactment or charter, does not affect the rights of the pledgee. Bankruptcy or insolvency laws take away none of the rights of the creditor to collateral securities held by him, under proper indorsement.[2] The receiver of an insolvent corporation occupies no better position in this respect, and has no greater right to a surrender of the collaterals as against a pledgee of stock for value advanced in good faith, without notice, than the cor-

[1] Shropshire Unions Ry. Co. *v.* Queen, L. R. 7 H. L. 496, 506 (Earl Cairns, Lord Chancellor).

[2] Jerome *v.* McCarter, 94 U. S. 734, 739; Yeatman *v.* Savings Institution, 95 Ib. 764; Bank of Louisville *v.* State Bank, 10 Bush, 367; Dayton Nat. Bank *v.* Nat. Bank, 37 Ohio, St. 208, 215; Dickinson *v.* Central Nat. Bank, 129 Mass. 279.

poration itself had.[1] In cases where, under statutory enactments, transfer of shares of stock upon the books of the company is required before a pledgee thereof can obtain the legal title, and there is a failure to comply therewith, the equitable title of the pledgee is defeated by an assignment of all his property by the pledgor.[2] An equitable mortgage of shares by deposit, where in order to secure the legal title under the charter, registry on the books of the company is required, and the pledgee has failed to make any transfer thereon, is not supported, as against an assignee in bankruptcy of the pledgor.[3] A pledge of stock certificates is not supported as against an assignment under insolvency laws, where the delivery of such certificates as collateral security was merely nominal, until in view of impending insolvency transfers of the legal title were executed and registered on the books of the company.[4] Shares of stock were deposited as collateral security with a bank for value, and were transferred by the pledgee to the names of its officers. Subsequently being indebted to a third person, the pledgor agreed in writing to hold his remaining interest in the shares as trustee for his benefit, and then became bankrupt. The second pledge was supported as against his assignee, subject to the claims of the bank.[5] Shares of stock standing on the books of a corporation in the name of a bare trustee, the certificate properly indorsed being in the possession of the true owner, do not pass in Massachusetts upon an assignment for the benefit of creditors of the trustee, as they are not "property" of the debtor under such insolvent laws.[6]

[1] Cutting *v.* Damerel, 88 N.Y. 410.

[2] Shipman *v.* Etna Ins. Co. 29 Conn. 245; City Fire Ins. Co. *v.* Olmstead, 33 Ib. 480; Dutton *v.* Connecticut Bank, 13 Ib. 493.

[3] Ex parte Boulton, 1 DeG. & J. 163.

[4] Nesbit *v.* Macomb Banking Assn. 12 Fed. Rep. 686.

[5] Ex parte Barry, L. R. 17 Eq. 113.

[6] Holmes *v.* Winchester, 133 Mass. 140; Sibley *v.* Quinsigamond Bank, Ib. 515; Chace *v.* Chapin, 130 Ib. 128; Hunnewell *v.* Lane, 1 Met. 163. But see Dutton *v.* Connecticut Bank, 13 Conn. 493; Shipman *v.* Etna Ins. Co. 29 Ib. 245.

§ 279. PLEDGES OF STOCK FOR ANTECEDENT DEBT AND FUTURE ADVANCES.—The rule prevailing in certain states that the holder of negotiable securities, receiving the same as collateral security for a pre-existing debt, without further consideration, is not a holder for value, in the usual course of business, is applied in cases where certificates of stock have been used as collateral security. The rule is enforced although the certificate itself has been delivered, properly indorsed, with full power to transfer the same on the books of the company.[1] Where, however, new and valuable consideration is given for such transfer as collateral security, the claims of the pledgee are supported to the extent of such new consideration, as being a present advance.[2] Upon a pledge of certificates of stock for an antecedent debt, new notes being given as evidence thereof, the pledgee is regarded as a holder for value within the rule, as the transaction amounts to a valid extension of the time for payment.[3] Pledges of stock are also sustained when made to secure future advances or proposed liabilities.[4]

§ 280. THE PLEDGEE OF STOCK CERTIFICATES ENTITLED TO DIVIDENDS.—The holder of certificates of stock as collateral security, receiving the same indorsed with a power of attorney in blank, is entitled upon notice to the company, to collect the dividends accruing on such stock while such certificate remains in his possession. Nor is transfer upon the books of the company material as to this right. Such collections are applied on the debt at maturity. The title

[1] Moodie *v.* Seventh Nat. Bank, 11 Phila. 366; Barton *v.* Peterson, 12 Ib. 397; Root *v.* French, 13 Wend. 570; Weaver *v.* Barden, 49 N. Y. 286; Gould *v.* Farmers' Loan and Trust Co. 23 Hun, 322; Roxborough *v.* Messick, 6 Ohio St. 448; Cleveland *v.* State Bank, 16 Ib. 236; Cherry *v.* Frost, 7 Lea, 1. A pledge of stock certificates for an antecedent debt was supported in ex parte Barry, L. R. 17 Eq. 113.

[2] Weaver *v.* Barden, Cherry *v.* Frost, and Moodie *v.* Nat. Bank, supra.

[3] Dayton Nat. Bank *v.* Merchants' Nat. Bank, 37 Ohio St. 208, 217.

[4] National Bank *v.* Hall, 18 Hun, 176; Eichelberger *v.* Murdock, 10 Md. 373.

to such dividends is in the pledgee, the increase of pledged property going with the debt.[1] The pledgee, indeed, is an owner; his special ownership imposes upon him the duties of a trustee. As such, he is bound to collect dividends. and may sue in his own name. It is not necessary that he should become absolute owner by foreclosure before suing for dividends on the stock.[2] And where stock is purchased by a broker for a customer, and held by him with his margins as security for the fulfilment by the customer of his engagements, interest or dividends accruing thereon will be credited to the latter.[3] Stock owned by C was pledged by B to A, but A had no notice of the ownership until after default in payment of the loan, when C requested him to delay the sale. C, having collected dividends on the stock during the delay, and the title to them being in the pledgee, C, as trustee for A, was required to pay them over.[4] Where dividends are collected by a pledgor, an action for money had and received for his use may be brought by the pledgee, where the latter has received the certificates of stock so as to vest the legal title in him.[5] But a mere delivery of certificates, without indorsement, or of a special property therein only, the pledgor remaining owner at the time of declaring the dividends, will not entitle the pledgee to collect them.[6]

[1] Gaty *v.* Holliday, 8 Mo. App. 118; Merchants' Nat. Bank *v.* Richards, 6 Ib. 454; aff. 70 Mo. 77; Herman *v.* Maxwell, 47 N. Y. Super. Ct. 347; Hill *v.* Newichawanick Co. 48 How. Pr. 429; Kellogg *v.* Stockwell, 75 Ill. 71; March *v.* Railroad Co. 43 N.H. 520; Conant *v.* Seneca County Bank, 1 Ohio St. 298; Hasbrouck *v.* Vandervoort, 4 Sandf. 74; Butterworth *v.* Kennedy, 5 Bosw. 143; Isaac *v.* Clark, 2 Bulst. 306. The right to collect dividends is recognized as to sub-pledgees, holding the title to the stock by proper indorsement of the certificates. Chamberlain *v* Greenleaf, 4 Abb. N. Cas. 178; but they must be accounted for. Ib.

[2] Merchants' Nat. Bank *v.* Richards, 6 Mo. App. 454; aff. 70 Mo. 77.

[3] Markham *v* Jaudon, 41 N. Y. 235; Chamberlain *v.* Greenleaf, 4 Abb. N. C. 178.

[4] Herman *v.* Maxwell, 47 N. Y. Super. Ct. 347.

[5] Hill *v.* Newickhawanick Co, 48 How. Pr. 429; Gaty *v.* Holliday, 8 Mo. App. 118.

[6] Dow *v.* Gould etc. Co., 31 Cal. 649.

§ 281. The Pledgee of Stock entitled to protect property of Company.—Equity will aid the pledgee of stock certificates, holding the same for value, with title, in cases where the pledgor is wasting the property and assets of the company, and destroying the value of the stock. The owner of the controlling interest in a company, having secured loans upon pledges of its stock, procured the conveyance by the company to third parties of almost all of its property. The pledgees brought suit to set aside the deeds, and for other relief. No transfer on the books being required to constitute a valid title to the stock, the pledgees possessed a right under their special ownership, to defend the property of the corporation paramount to the right of the pledgor, or of any subsequent purchaser of the same stock from the legal owner while the certificates remained in their possession. Nor would they be required to bring an action in the name of the corporation having no control over its proceedings.[1] Pledgees of stock, having the legal title, and registration on the books of the company, were given equitable aid in protecting the property represented by the shares from diversions or liens improperly created, notwithstanding the pledgor's right of redemption, and equitable reversionary interest in the stock.[2]

[1] Baldwin *v.* Canfield, 26 Minn. 43.

[2] Vail *v.* Hamilton, 85 N. Y. 453.

CHAPTER XXVIII.

THE PLEDGEE, UPON TRANSFER, A STOCKHOLDER.

§282. The pledgee, upon transfer, a stockholder.
283. Or by his acts, in relation to the stock, voting, receiving dividends, etc.
284. The rule as controlled by statutory provisions.
285. The pledgee of stock not released until re-transfer.
286. Transfer so as to protect pledgees from liabilities.
287. Equitable relief of pledgor as against transfer.
288. The transfer of title by pledgee not a conversion of the stock.

§ 282. THE PLEDGEE, UPON TRANSFER, A STOCKHOLDER.—The pledgee of certificates of stock, indorsed with power of attorney to transfer, who has obtained transfer on the books of the company and received new certificates, becomes by his voluntary act, a stockholder in such company, with all the rights and liabilities of that position. By means of such transfer and the issue of such new certificates, the pledgee acquires a complete and absolute title to the shares of stock deposited as collateral security, and is enabled to render his security available by sale, upon default of the pledgor upon the principal debt, and notice of sale. In the absence of statutory restriction, no stockholder can have greater rights, or be subject to other liabilities, than the pledgee thus transferring his stock collaterals upon the books of the company issuing the same, and receiving new certificates.[1] Any secret trust

[1] National Bank *v.* Watsontown Bank, 105 U. S. 217; National Bank *v.* Case, 99 U. S. 628; Pullman *v.* Upton, 96 Ib. 328; Bowden *v.* Farmers' Bank, 1 Hughes, 307; Heath *v.* Griswold, 18 Blatch. 555; Wheelock *v.* Kost, 77 Ill. 296; Adams *v.* Sturgess, 55 Ib. 468; Adderley *v.* Storm, 3 Hill, 624; Roosevelt *v.* Brown, 11 N. Y. 18; In re Empire City Bank,

existing as between the pledgor and pledgee of stock collaterals, under such transfer and issue of new certificates, will afford no defense to the pledgee as against third parties who have acted upon the statements as to ownership of stock appearing upon the books of the company. He assumes the liabilities as well as enjoys the rights and privileges of being a stockholder.[1] Such transfer by the pledgee upon the books of the company severing the relation theretofore existing between the pledgor and the company, the liens or claims existing upon such stock as to the latter no longer have any vitality. The transfer by the corporation is an abandonment of any such lien, the pledgee, as a new stockholder, entering into his relations with the company entirely untrammeled by any antecedent claims.[2]

18 Ib. 199; Johnson *v.* Underhill, 52 Ib. 203; Vail *v.* Hamilton, 85 Ib. 453; Brewster *v.* Sime, 42 Cal. 139; Hale *v.* Walker, 31 Iowa. 344; Albert *v.* Savings Bank, 1 Md. Ch. 407; Magruder *v.* Colston, 44 Md. 349; Holyoke Bank v. Burham, 11 Cush. 183; Bank *v.* Goodman, 9 Cush. 576; Crease *v.* Babcock, 10 Metc. 525; Barre Nat. Bank *v.* Hingham Man. Co., 127 Mass. 563, 571; McCalla *v.* Clark, 55 Geo. 53; Aultman's App. 98 Pa. St. 516; Railroad Co. *v.* Stewart, 41 Ib 54; Griswold *v.* Seligman, 72 Mo. 110; Fisher *v.* Seligman, 75 Ib. 13; see Burgess *v.* Seligman, 107 U. S. Rep. 20; Franklin Bank *v.* Commercial Bank, 36 Ohio St. 350; In re Tahiti Cotton Co., L. R. 17 Eq. 273; In re Northern Assam Tea Co., L. R. 10 Eq. 458. But a pledgee of shares, although receiving them with full power of attorney to transfer, can only become the owner thereof by a bona fide sale upon default, and purchase, no transfer having been made upon the books of the company. Until such sale and purchase, the pledgee is not entitled to the rights nor subject to the liabilities of an owner of shares. Beecher *v.* Wells Flouring Mills Co. 1 McCrary, 62.

[1] Aultman's App. 98 Pa. St. 516.

[2] National Bank *v.* Watsontown Bank, 105 U. S. 217. A pledge of a certificate of stock in the Watsontown Bank was made to the Cecil National Bank upon a discount of two notes, with power of sale of the collaterals upon non-payment. Default occurring, the pledgee forwarded the certificate to the bank for transfer, which was done by the entry in a stock ledger of debtor and credit items, but no certificate was forwarded, the pledgee requesting the cashier to sell the stock, which was done with a few shares. The pledgor became insolvent, whereupon the bank refused to transfer, claiming a statutory lien on the stock. The court (Matthews, Jus.) say: "A complete transfer of the title to the stock upon the books of the bank, it is not doubted, would have the

§ 283. Or by his Acts in relation to the Stock, voting, receiving dividends, etc.—A person may by his acts or conduct in respect to the stock of a corporation, render himself liable to the responsibilities of a stockholder, and will be estopped to deny such liability as against third persons, creditors, and others who have been deceived

effect to vest it in the transferee, free from any claim or lien of the bank. The consent of the bank, made necessary to such transfer, is the waiver of its right, as its refusal would be the assertion of it. The transfer, when thus consummated, destroys the relation of membership between the corporation and the old stockholder, with all its incidents, and creates an original relation with the new member, free from all antecedent obligations. This legal relation and proprietary interest, on which it is based, are quite independent of the certificate of ownership, which is mere evidence of title. The complete fact of title may very well exist without it. All that is necessary, when the transfer is required by law to be made upon the books of the corporation, is that the fact should be appropriately recorded in some suitable register or stock list, or otherwise formally entered upon its books. For this purpose the account in a stock ledger, showing the names of the stockholders, the number and amount of the shares belonging to each, and the sources of their title, whether by original subscription and payment or by derivation from others, is quite suitable, and fully meets the requirements of the law. Accordingly, when the cashier of the Watsontown Bank received from Tome the certificate with the authority for its transfer to him duly executed by Powell & Co., and, in pursuance of the request to make the transfer, charged it in the account against the former owner, and gave to Tome the corresponding credit, the latter became a stockholder in the bank, invested with the legal title to the stock, and with all the rights, powers, and privileges belonging to that character. Nothing more remained to be done to make the conveyance of title complete and absolute, and, so far as the bank was concerned, it was irrevocable. It had consented to the transfer, and the transfer had been made. Thenceforward the rights of Tome in respect to the stock in question were all that they could have been if it had belonged to him by virtue of an original subscription. The claim of the bank upon it, based upon the existing relation with the former owner, ceased when, with its consent and through its act, that relation ceased.

The Cecil National Bank, then, had become the owner of the legal title to the stock which Powell & Co. transferred, and was entitled to demand recognition from the bank of its rights as a stockholder, and to the customary certificate, as evidence of its ownership."

thereby to their loss.[1] In the absence of restrictive statutes, the pledgee of certificates of stock, indorsed and transferred on the books of the company, has a right to vote at its meetings. His name appearing as stockholder upon the records of the corporation, he becomes for all purposes a stockholder. The right to vote is an incident of the pledge, and according to the presumed intentions of the parties.[2] Where such stock remains in the name of the pledgor on the books of the company, the right to vote remains with him.[3] A pledgee holding certificates of stock as security, who, after transfer thereof and issue of new certificates, votes at meetings of the company, is not liable to an action of trover for the conversion of such certificates.[4] Nor will a court of equity grant its restraining power in aid of a pledgor of stock against a trustee who is holding the same as collateral

[1] Webster *v.* Upton, 91 U. S. 65; Upton *v.* Trebilick, Ib. 45; National Bank *v.* Case, 99 Ib. 628; Farrar *v.* Walker, 3 Dill. 506; Bank *v.* Goodman, 9 Cush. 576; American Ry. Frog Co. *v.* Haven, 111 Mass. 398; State *v.* Leete, 16 Nev. 242; Wheelock *v.* Kost, 77 Ill. 296; Griswold *v.* Seligman, 72 Mo. 110; Fisher *v.* Seligman, 75 Ib. 13; in re Strafforn's Exec. 3 DeG. & S. 31; Davidson's case, 3 DeG. & S. 21; Tracy *v.* Yates, 18 Barb. 152; Spear *v.* Crawford, 14 Wend. 20; Burr *v.* Wilcox, 22 N.Y. 551: Wheeler *v.* Miller, 90 N Y. 353.

[2] Ex parte Wilcocks, 7 Cow. 410; in re Barker, 6 Wend. 509; in re Long Island R. R. Co. 19 Ib. 37; Adderly *v.* Storm, 6 Hill, 624; Rosevelt *v.* Brown, 11 N. Y. 149; in re Empire City Bank, 18 Ib 199; Vail *v.* Hamilton, 85 Ib. 453; Chase *v.* Bank, 19 Pick. 584; Griswold *v.* Seligman, 72 Mo. 110; Fisher *v.* Seligman, 75 Ib. 13; Railroad Co. *v.* Stewart, 41 Pa. St. 54; Hoppin *v.* Buffum, 9 R. I. 513; see Burgess *v.* Seligman, 107 U. S. Rep. 20. "A person in whose name the stock of the corporation stands on the books of the corporation is, as to the corporation, a stockholder, and has the right to vote upon the stock. * * Nor would this result follow any the less certainly if the shares of stock were received in pledge only to secure the payment of a debt, providing the shares were transferred on the books of the company to the name of the pledgee," Franklin Bank *v.* Commercial Bank, 36 Ohio St. 10.

[3] McDaniels *v.* Flower Brock Manuf. Co. 22 Vt. 274; Merchants' Bank *v.* Cook, 4 Pick. 205; Strong *v.* Smith, 15 Hun, 222; in re Barker, 6 Wend. 509; in re Cecil, 36 How. Pr. 477; ex parte Wilcocks, 7 Cow. 410.

[4] Heath *v.* Silverthorn Co. 39 Wis. 146.

security for the benefit of a third person, the same having been transferred to the name of the trustee to prevent the pledgor from voting thereon. Relief will not be given although by the allegations of the bill the pledgor would suffer irreparable injury if the trustee should be permitted to vote, but presenting no facts in support; nor a writ of injunction issued to restrain the violation of a mere legal right of property.[1] The receipt of dividends on stock is sufficient to make a man a stockholder, as the responsibilities of the position go with the advantages.[2]

§ 284. THE RULE, AS CONTROLLED BY STATUTORY PROVISIONS.—The liabilities of a holder of certificates of stock as collateral security as a stockholder, are the subject of statutory regulation. The provisions of such statutes generally relieve the pledgee of stock from any personal liability as stockholder, although he has received the full title to the stock, and has the better to render his security more available procured the transfer of such stock to his own name on the books of the company and received new certificates. The responsibilities of a stockholder are placed by such statutes upon the pledgor. In a Maryland case, in which state, under statutory provisions, the holders of stock as collateral security are exempted from liability as stockholders, an advance of money was made for the benefit of a corporation, and as collateral security a certificate of stock was issued to the pledgee, and subsequently indorsed by the president of the company as being issued as "collateral security." Creditors of the company were not allowed, in a suit in equity, to enforce the pledgee's alleged liability as stockholder.[3] And in a New York case, under a like statute, and imposing the liabilities of stockholders upon the pledgor, the pledgee was permitted to show that the trans-

[1] McHenry *v.* Jewett, 90 N. Y. 58; rev. s. c. 26 Hun, 453.

[2] Pullman *v.* Upton, 96 U. S. 328; National Bank *v.* Case, 99 Ib. 628; Hale *v.* Walker, 31 Iowa, 344; Wheeler *v.* Kost, 77 Ill. 296.

[3] Matthews *v.* Albert, 24 Md. 527.

fer of the legal title of the stock on the books of the company, and the issue of certificates, were only for the purpose of collateral security.[1]

In Missouri it is provided by statutes that no person holding stock as collateral security shall be personally liable as a stockholder, but the pledgor is considered as holding the stock, and liable; and that upon the dissolution of corporations, stockholders may be sued directly upon their liability by judgment creditors of the company. The Supreme Court of Missouri,[2] construing these provisions, refused to apply such exemption in a case where a corporation had pledged its own unissued and unsubscribed stock to New York bankers as collateral security for advances, and to secure the payment of bonds to be negotiated by them for the benefit of the company, as in such case there could be no pledgor to whom creditors could resort, as provided in the statute. The banking firm having received the legal title to the stock, although the transfer was described in the original agreement as being "in trust," and the stock certificates were entered upon the stock ledger as being "held in escrow," and voted by proxy at an annual meeting of the stockholders, and obtained control of the organization, was estopped to deny it was a stockholder, and under statutory liability to judgment creditors for debts of the company after its legal dissolution. The United States Supreme Court, considering the statutes, upon a claim of another judgment creditor arising out of the same transactions,[3] found the transfer to be clearly one of collateral security, the stock being held by the bankers for their own security and that of the purchasers of bonds issued in connection therewith; that as the Missouri statute recognized the holding of stock as collateral security without a pledgee incurring liability as a stockholder, no

[1] McMahon *v.* Macy, 51 N. Y. 155.

[2] Griswold *v.* Seligman, 72 Mo. 110; Fisher *v.* Seligman, 75 Ib. 13; 1 Wagner's Stats. Mo. c. 27, Art. 1, §22; c. 27, Art 1, §9.

[3] Burgess *v.* Seligman, 107 U. S. Rep. 20.

one could complain except the other stockholders of the fact of voting by the pledgees, or of their obtaining control of the company under a previous understanding, the transaction resulting in no injury, but rather a benefit to creditors. The stock stood as security for large advances made in good faith by the pledgees, the money being used for the benefit of the company, which was itself primarily liable for its debts.

§ 285. THE PLEDGEE OF STOCK NOT RELEASED, UNTIL RE-TRANSFER.—The liability of the pledgee of stock who has caused transfer of the same upon the books of the company is continued as to the company and creditors, notwithstanding the payment of the debt or obligation for which the stock was indorsed as collateral. The liability ceases only upon a re-transfer of the stock to the name of the pledgor.[1] Such liability cannot be avoided by a colorable transfer to an irresponsible person. In such case the transaction will be decreed to be a fraud on the creditors of the corporation, and the transferrer held to the same liability as before.[2] As said, in a late Missouri case, involving the liability of a pledgee of stock, who had taken legal title thereto, "Courts will be sedulous in their endeavors to defeat all schemes and contrivances whereby parties may seek to receive and enjoy the benefits and privileges incident to the position of stockholders, and at the same time be exonerated from the burdens imposed by law."[3] The necessity of a re-transfer to avoid liability is illustrated in a case where a pledgee having transferred certificates of stock held as collateral security to his own name, retained the title to the stock at the request of the pledgor, after payment of the debt, in order to sell the same for the latter's

[1] Adderly *v.* Storm, 6 Hill, 624; Johnson *v.* Underhill, 52 N. Y. 203; Commercial Bank *v.* Kortright, 20 Wend. 91; Walker *v.* Bennett, 18 C. B. 845.

[2] Bowden *v.* Johnson, 107 U. S. Rep. 251; National Bank *v.* Case, 99 U. S. 628; Davis *v.* Stevens, 17 Blatchf. 259.

[3] Fisher *v.* Seligman, 75 Mo. 13.

benefit. The company became insolvent, and the pledgee returned the stock to the pledgor indorsed in blank. While holding the stock as collateral security the pledgee was, under a statutory provision, relieved from liability as a stockholder; but after the debt was paid, the relation of of pledgee and pledgor ceased, and as to creditors of the company the pledgee became a stockholder with all the accompanying liabilities.[1]

§ 286. TRANSFER SO AS TO PROTECT PLEDGEE FROM LIABILITIES.—The transfer of certificates of stock as collateral security for an independent debt may be made so as to show the restricted interest of the pledgee therein, and at the same time protect him from liability as a stockholder. Such notice may be given by the terms of the indorsement on the certificate itself, and will charge subsequent transferees. The transfer should show that it is made as and for collateral security, and should sufficiently describe the debt to secure the payment of which it is delivered in pledge.[2] Upon a transfer of certificates of stock in pledge, an indorsement showing the delivery to be "as collateral security" was sufficient notice of the pledgee's limited interest to entitle him to the benefit of statutory exemptions from liability.[3] But in another case, where a certificate of stock had been originally pledged showing that it was transferred "as collateral," and upon payment the certificate was indorsed in blank by the pledgee to the pledgor, who again pledged the same for value, it was held the second pledgee was not put upon inquiry by the words "as collateral" upon the certificate, the name of the pledgor not appearing thereon, and the possession of the pledgor of itself not being sufficient to show that he was the person for whom the stock had formerly been held as collateral. Notwithstand-

[1] Erskine *v.* Lowenstein, 11 Mo. App. 595.

[2] Barre Nat. Bank *v.* Hingham Manuf. Co. 127 Mass. 563, 571.

[3] Matthews *v.* Albert, 24 Md. 527.

ing the certificate was grossly tainted with forgery committed by the pledgor, who was bankrupt, the second pledgee was allowed to recover on the indorsement made by the first pledgee.[1] The holder of a certificate of stock may also show by evidence outside of the certificate, although its statements are absolute as to his ownership thereof, that such certificate does not belong to him as owner; and the same rule applies as to statements as to who are stockholders, contained in the books of a corporation.[2]

§ 287. EQUITABLE RELIEF TO PLEDGOR AS AGAINST TRANSFER.—Where certificates of stock have been pledged as collateral security by delivery, together with a power of attorney to transfer, and the pledgee has elected to make such transfer on the books of the company and to receive a new certificate in his own name, so as to become vested with the legal title and ownership of the stock, a court of equity, upon a proper case, will entertain a bill for the purpose of establishing the trust existing in such shares, and if entitled thereto, relief will be given the pledgor, generally by a decree requiring the certificates of stock to be surrendered properly indorsed to the pledgor upon the equitable terms of payment of the loan with interest, and such assessments as have been rightfully paid by the pledgee, and subject to proper credits for dividends received by him.[3] Parol testimony is received to establish the fact that the transfer of such certificates was intended as collateral security only, although absolute in terms.[4] This principle was applied to a stock transac-

[1] Matthews *v.* Mass. Nat. Bank, Holmes, 410.

[2] McMahon *v.* Macey, 51 N.Y. 155; Tonica etc. Ry. Co. *v.* Stein, 21 Ill. 90; Jones *v.* Portsmouth Ry. Co. 32 N. H. 544; Pittsburgh Ry. Co. *v.* Stewart, 41 Pa. St. 54; Lathrop *v.* Kneeland, 46 Barb. 432.

[3] Brick *v.* Brick, 98 U. S. 514; Newton *v.* Fay, 10 Allen, 505; Gilpin *v.* Howell, 5 Pa. St 41; Pinkerton *v.* Manchester R. R Co. 42 N.H. 424; McCalla *v.* Clark, 55 Ga. 53.

[4] Ibid McMahon *v.* Macy, 51 N.Y. 155; Burgess *v.* Seligman, 107 U. S. Rep. 20; Lathrop *v.* Kneeland, 46 Barb. 432, Jones *v.* Portsmouth R.R. Co. 32 N H. 544; Pittsburgh R.R.Co. *v.* Stewart, 41 Pa St. 54; Tonica R. R. Co. *v.* Stein, 21 Ill. 96.

tion, where the assignment of title was absolute, the rule excluding parol testimony to vary or contradict a written instrument having reference only to the language used therein and not forbidding inquiry into the object of the parties in executing and receiving the same. A deed may be shown by parol evidence to have been made to defraud creditors, to give a preference, or to secure a loan; and the rule applies with equal force to instruments purporting to transfer personal property.[1]

§ 288. THE TRANSFER OF TITLE BY PLEDGEE NOT A CONVERSION OF STOCK.—The purpose of indorsing certificates of stock with an irrevocable power of attorney to transfer and generally of substitution, is to enable the pledgee upon default in the principal debt, to render his securities available. In the absent of such indorsement of the power of attorney to transfer certificates of stock, the pledgee takes a doubtful security, as his title is but equitable, and subject to prior equities, whether known or not.[2] The pledgee, holding the legal title to the certificates as between the parties to the contract of pledge it is essential in certain states, under statutory enactments, in order to protect his collateral securities against the claims of third persons, and of the corporation, that transfer should be made upon the books of the company, and new certificates issued. A transfer and the issue of new certificates is not a conversion of the stock.[3] The same right of transfer for better security as against the pledgor, may be exercised by

[1] Brick *v.* Brick, 98 U. S. 514; Burgess *v.* Seligman, 107 U. S. Rep. 20.

[2] Rich *v.* Boyce, 39 Md. 314, 327.

[3] Rich *v* Boyce, supra; Heath *v.* Griswold, 18 Blatchf. 555; Adams *v.* Sturges, 55 Ill. 468; Heath *v.* Silverthorn Co. 39 Wis. 146. The pledgee was not charged with a conversion where stock was held as collateral to secure a debt, and transferred on the books of the company to relatives to avoid liability as stockholder, the certificates being indorsed with power of attorney to transfer to the pledgee. Heath *v.* Griswold, 18 Blatchf. 555.

a sub-pledgee holding certificates of stock with full title.[1] A transfer of certificates of stock held in pledge to third persons with a view of avoiding injury to the credit of the pledgee, he retaining the control and possession of the new certificates, indorsed, ready to be returned to the pledgor, will not amount to a conversion of the stock, in the absence of tender or payment of the debt, demand of the stock, and refusal to transfer.[2] Nor is it a conversion, as against a partnership, where shares of stock were transferred by one of its members, holding them for the benefit of a third person, with power of sale, and subsequent transfers were made to and from the firm, with all of which it had nothing to do, the individual partner keeping the certificates in his possession.[3]

[1] In re Tahiti Cotton Co. L. R. 17 Eq. 273.

[2] Day *v.* Holmes, 103 Mass 306.

[3] Adams *v.* Sturges, 55 Ill. 468.

CHAPTER XXIX.

THE PLEDGEE'S RIGHTS, AS AGAINST LIENS.

§289. The pledgee of stocks, when not subject to liens of company.
290. The company's lien, by statute or charter.
291. Limitations and loss of company's lien.
292. The enforcement of company's lien, as against pledgee.
293. The pledgee of stocks a holder for value against creditors.
294. Pledges with transfer supported as against creditors.
295. The creditor's lien, as against pledgee, under statutory enactments.

§ 289. PLEDGEES OF STOCK, WHEN NOT SUBJECT TO LIENS OF COMPANY.—A pledgee for value, without notice of equities, of certificates of stock receiving the same with a power of attorney to transfer indorsed thereon, so as to convey the legal title and ownership, in the usual course of business, is protected as against secret liens of the company equally with purchasers for value in good faith of such certificates of stock. Such pledgees, holding the legal title and possession of the certificate, are not subject to liens or claims of the company issuing the same, based upon any rule or by-law restricting the transfer of stock until payment of the indebtedness of the pledgor, where the lien is not given by statutory enactment or by provisions of the charter of the corporation.[1] Such secret liens are not favored

[1] Case *v.* National Bank, 100 U. S. 446; National Bank *v.* Watsontown Bank, 105 Ib. 217; Carroll *v.* Mullanphy Co., 8 Mo. App. 249; Driscoll *v.* Bradley Manf. Co. 59 N. Y. 96; New Orleans Nat. Bkg. Assn. *v.* Wiltz, 10 Fed. Rep. 330; Bryon *v.* Carter, 22 La. Ann. 98; Smith *v.* Slaughter House Assn. 30 Ib. 1478; Moore *v.* Bank, 52 Mo. 379; Carroll *v.* Mullanphy Savings Bank, 8 Mo. App. 249; Union Bank *v.* Laird, 2 Wheat. 390; Bank *v.* Lanier, 11 Wall. 369; Bullard *v.* Bank, 18 Wall. 598; Bank of Attica *v.* Manufacturers' Bank, 20 N. Y.

as against bona fide holders for value of certificates of stock indorsed with a power of attorney to transfer, thus holding the title to the shares of stock. No presumption arises in favor of the company refusing to transfer such shares, by reason of any claim of which such holder for value is not chargeable with notice.[1] A power given by charter provisions to pass by-laws for the regulation of transfers of stock certificates will not entitle a company to create a secret lien upon the shares of stocks in the hands of a bona fide holder for value, without notice of the by-law;[2] nor to pass a by-law claiming a lien

505; Rosenback *v.* Bank, 53 Barb. 495; Massachusetts Iron Co. *v.* Hooper, 7 Cush. 183; Sargeant *v.* Ins. Co. 8 Pick. 90; Nesmith *v.* Washington Bank, 6 Ib. 329; Steamship Dock Co. *v.* Heron, 52 Pa. St. 280; Geyer *v.* Insurance Co. 3 Pittsb. 41; Bank of Holly Springs *v.* Pinson, 58 Miss. 421, 435. A general assignee of the stockholder was held to take subject to the lien of the corporation. Waln *v.* Bank, 8 S. & R. 73. And where the face of the stock contained a statement of the liability. Van Sands *v.* Middlesex County Bank, 26 Conn. 144. In Cornick *v.* Richards, 3 Lea, 23, the court (Freeman, J.) say: "Stocks are used every day in the transactions of our business men as collaterals as well as sold, and the universal practice is to transfer or assign the certificate of the stock, with a power of attorney in blank, to be filled up, authorizing the transfer by the corporation on its books to the purchaser, on the presentation of which power properly authenticated, the corporation transfers the stock to the purchaser or holder; and when the sale is absolute, it is usual to issue new certificates to the party taking up the old. Such a practice facilitates the easy use of this property in commercial transactions. The rule requiring transfer on the books of the corporation can only serve to give the creditor who has a judgment or execution, a legal advantage, who has never given credit on the faith of the stocks over the other who has advanced his money on them, and taken the evidence of his security by a transfer of his certificate. In such case, the equities are altogether in favor of the assignee who has advanced his money on the faith of the collaterals."

[1] Bullard *v.* Bank, 18 Wall. 589; Bank *v.* Lanier, 11 Wall. 369; Carroll *v.* Mullanphy Savings Bank, 8 Mo. App. 249; Driscoll *v.* West Bradley Manf. Co. 59 N. Y. 96; Mass. Iron Co. *v.* Hooper, 7 Cush. 183; Steamship Dock Co. *v.* Heron, 52 Pa. St. 280; Sargeant *v.* Franklin Ins. Co. 8 Pick. 90.

[2] Anglo-Californian Bank *v.* Bank, 61 Cal. (16 C. L. N. 313); Driscoll *v.* West Bradley Manf. Co. 59 N. Y. 96; State Ins. Co. *v.* Gennett,

that all debts due to the corporation shall be discharged before permitting a transfer of stock as against such bona fide holder for value, and without notice.[1] In Louisiana, a pledge of shares of stock, by delivery of the certificate, is supported, although at the time the pledgor be indebted to the corporation, and such transfers were prohibited by the charter of the corporation, shares of stock not being "credits," within the meaning of the Louisiana code.[2]

As no statutory lien upon the shares of their stockholders for indebtedness is given to national banks, the delivery of certificates of stock of such banks as collateral security, with an irrevocable power of attorney to transfer indorsed thereon, to a pledgee for value, without notice, defeats any claim of a lien on the stock against the pledgor, although the latter has become insolvent. The title to the shares, as against such lien, passes upon a transfer for value, in good faith, of the certificate.[3] And an innocent pledgee for value of shares of stock of a national bank, holding them under indorsement, with irrevocable power to transfer, will be entitled to recover, as against the bank refusing a transfer, after notice that the pledgor, who was indebted to it, had been adjudicated a bankrupt, the value of the stock (having first been paid the accrued dividends) less taxes, to the amount of his advance, the stock to be sold at public sale.[4]

§ 290. THE COMPANY'S LIEN, BY STATUTE OR CHARTER. —Under general statutes giving authority to regulate the transfer of stock, it may be provided that no transfer shall be made upon the books of the company until after payment

2 Md. Ch. 100; Bullard *v.* Bank, 18 Wall. 589; United States *v.* Vaughan, 3 Binn. 394.

[1] Anglo-Californian Bank *v.* Bank, supra.

[2] Pilot *v.* Jackson, 32 La. Ann. 1286.

[3] National Bank *v.* National Bank, 10 Bush. 367; Rosenback *v.* Salt Springs Nat. Bank 53 Barb. 495.

[4] Dayton Nat. Bank *v.* Bank, 37 Ohio St. 217

of all indebtedness to the company by the person who appears to be the owner, and to whose name the stock is credited on its books.[1] Such lien extends to all the stock of the debtor, although it greatly exceeds the amount of the debt; nor will the lien be barred by the running of the statute of limitations against the debt.[2] Where a by-law required the special consent of the directors to a transfer of

[1] Pendergast *v.* Bank, 2 Sawy. 108; McDowell *v.* Bank of Wilmington, 1 Harr. (Del.) 27; Lockwood *v.* The Banks, 9 R. I. 308; Waln *v.* Bank of North America, 8 S. & R. 86; McDowell *v.* Phœnix Fire Ins. Co. 3 Paige's Ch. 350; McCready *v.* Rumsey, 6 Duer, 574; Leggett *v.* Bank, 24 N. Y. 283; Tuttle *v.* Walton 1 Kelly (Geo.) 43; Sabin *v.* Bank of Woodstock, 21 Vt. 253. In National Bank *v.* Watsontown Bank, 105 U. S. 202, the last named bank claimed a lien upon the stock of the pledgor as against the other bank, holding it through its president, as collateral security. The Pennsylvania statute regulating banks, sect. 10, art. 10, approved April 10, 1850, provided that "the stock of the bank shall be assignable and transferable on the books of the corporation only, in such manner as the by-laws shall ordain; but no stockholder indebted to the bank for a debt actually due and unpaid shall be authorized to make a transfer or receive a dividend until such debt is discharged or security to the satisfaction of the directors given for the same." The court (Matthews, Jus.) say: "The title [of the pledgee] was unquestionably subject to the lien given by its charter to the Watsontown Bank. That provision when insisted on and enforced, would be effectual to subject the beneficial interest in the stock to the payment of any indebtedness from the stockholder, making the transfer, to the bank for the debt which, at the time of the proposed transfer, was actually due and unpaid. According to the terms of this provision the bank was properly represented, in the act of transfer, by its cashier; and he was authorized to bind the bank, in consummating the transaction, by virtue of his office, in the absence of any by-law, according to the usage of the business and the practice of the particular bank, presumed to be known to and approved by the directors. Case *v.* Bank, 100 U. S. 446." The pledgee of stock, by delivery of the certificate and possession, is subject, under the Louisiana Code, to all the liens and privileges which the law puts upon it. Succ. of Rosseau, 23 La. Ann. 3; Hoss *v.* Williams, 24 Ib. 568; N. O. Banking Assn. *v.* Wiltz, 30 Ib. 1378. A lien on stock given to a corporation by its articles of association under a general law, was supported as against a cestui que trust, in New London Bank *v.* Brockle-bank, L. R. 21 Ch. D. 302; Childs *v.* Hudson's Bay Co. 2 P. Wms. 207.

[2] Geyer *v.* Insurance Co. 3 Pittsb. 41.

stock while the transferrer was indebted to the company, a lien was given on the stock of one partner for a debt owing by the firm.[1] The lien is not defeated by the taking of collateral security for the payment of any particular debt of the stockholder.[2] And upon the equitable principle of subrogation, a surety or accommodation maker or indorser, upon paying the debt, the creditor corporation having a lien under a statute or its charter upon the stock owned by the principal debtor, may enforce such lien.[3] A statutory lien in favor of a corporation extending to "all debts due" from the stockholder, covers an old indebtedness upon stock previously pledged to a third person, by delivery of the certificate with power of attorney to transfer, but of which no notice was given to the corporation. And it is immaterial, as against the claim of such statutory lien, that the certificate of stock itself contains no notice of any lien of the company.[4] In another case, the trustees of an estate had invested its funds in the capital stock of a company, which was entitled to a lien on shares for all moneys owing to it, individually or jointly, and as against all the holders of a share. One of the trustees was a member of a partnership, which being in debt to the company, became bankrupt. The lien of the bank prevailed over the cestuis que trust, although as between the latter and the trustees, quære whether such an investment was authorized.[5]

§ 291. Limitations and loss of Company's lien.— A company is not allowed to enforce even a statutory lien for an indebtedness incurred by the assignor of the certificate of stock, after notice of the transfer of the stock.[6] Nor

[1] Mechanics' Bank *v.* Earp, 4 Rawle, 384; Geyer *v.* Ins. Co. supra.

[2] Union Bank *v.* Laird, 2 Wheat. 390.

[3] Ibid.; Klopp *v.* Lebanon Bank, 46 Pa. St. 88.

[4] First Nat. Bank *v.* Hartford Ins. Co. 45 Conn. 22.

[5] New London Bank *v.* Brocklebank, L. R. 21 Ch. D. 302.

[6] Conant *v.* Seneca Co. Bank, 1 Ohio St. 298.

will the lien extend to an indebtedness represented by a bill of exchange held by a corporation not then arrived at maturity, of which the stockholder was the drawer.[1] And being a mere right of detention on the part of the company to make such lien available for the actual recovery of the debt, a judgment must be levied upon the shares, and the same sold under execution.[2] A power to fix the mode of transfer of stock in charter or articles of association excludes any attempt to do it by way of by-law.[3] A mere right under a general statute authorizing the adoption of by-laws regulating the transfer of stocks, will not support a by-law adopted at a meeting of the board of directors only.[4] Nor will such a by-law or rule, so adopted, be allowed to affect the rights of bona fide holders of stock, advancing money thereon, without notice.[5]

The right of a corporation to assert a statutory lien on the stock of its shareholders to secure the payment of their liabilities to it, are subject to waiver, and to be defeated and lost by the laches of the corporation in asserting the same, where such enforcement would operate as a fraud upon innocent third parties, holding for value, and mislead by assurances equivalent to a renunciation of the statutory claims of the corporation. The rule is applied in cases where, by reason of delay in the assertion of its lien, a pledgee holding certificates of stock which he is seeking to transfer into his own name, has lost an opportunity of obtaining other security, or of availing himself of other means of enforcing his claims against the pledgor.[6] And a corporation, where it has sold out the stock of one of its

[1] In re Stockton etc. Co. L. R. 2 Ch. D. 101.

[2] West Branch Bank *v.* Armstrong, 40 Pa. St. 278.

[3] Bank of Utica *v.* Bank, 20 N. Y. 501.

[4] Morton etc. Co. *v.* Wysong, 51 Ind. 4; Union Bank *v.* Ridgeley, 1 Har. & G. 324; Carroll *v.* Mullanphy Savings Bank, 8 Mo. App. 249; Rex *v.* Westwood, 2 Dow. & C. 21.

[5] Bank of Holly Springs *v.* Pinson, 58 Miss. 421; Carroll *v.* Mullanphy Banking Co., supra.

[6] National Bank *v.* Watsontown Bank, 105 U. S. 17, 23; Case *v.* Bank, 100 U. S. 446.

shareholders, under a power claimed by it, but which authority was not exercised in accordance with the provisions of its charter, is liable to the stockholder for the damages sustained by such wrongful sale. Nor is the stockholder required to make the transferee of the stock, so sold, a party to his bill seeking relief.[1]

§ 292. The enforcement of Company's lien as against Pledgee.—The provision in the charter of a company that a stockholder, before he can obtain a transfer of his shares on the books of the company, shall be required to pay all moneys due from him to the company, creates no lien or charge upon such shares of stock, as no enforcement thereof by the company, even by suit in equity, is possible until the stockholder himself desires to make such transfer. A stockholder in a banking company having such charter provision, made an equitable mortgage to the company of certain title deeds as security for specific loans, and shortly afterwards died, devising the estates, the title deeds of which had been pledged, to certain legatees. The claim of the latter that the company should be required by a court of equity to enforce payment of its loan by availing itself of its charter provisions relative to the stock as well as by the sale of the estates covered by the equitable mortgage, was not approved. The provision as to stock not being in any sense a security, no claim for contribution could arise relative thereto.[2] And that if such claim for contribution had arisen, the title deeds having been equitably mortgaged for the specific debt, would have to be exhausted before any resort was had to the stock.[3]

§ 293. The Pledgee of stocks a Holder for value, as against Creditors.—In the absence of statutory enactments or charter provisions requiring transfer upon the

[1] Duncan *v.* Hinckley, 2 McN. & G. 30.

[2] In re Dunlop, L. R. 21 Ch. D. 583.

[3] Ibid; Bute *v.* Conyngham, 2 Russ. 275, 299; Averal *v.* Wade, Lloyd & G. 252.

books of the corporation issuing certificates of stock, the owner may transfer the legal title and ownership of the shares of stock represented thereby, by delivery of the certificates indorsed with a power of attorney to transfer in blank, or filled with the name of the person advancing value thereon. The title acquired by a bona fide pledgee for value, without notice, is not subject to be divested or defeated by the subsequent issue of legal process by creditors of the pledgor against such stocks, although no transfer of the stock has been made upon the books of the company. The equity of the pledgee advancing money upon the representations of the certificates is preferred.[1] Protection is especially afforded to an innocent pledgee for value, in cases where by reason of the fraudulent delay and refusal of the officers of a corporation to make upon demand the necessary transfer of shares of stock upon its books, a creditor is enabled to issue legal process against the stock as belonging to the pledgor.[2]

[1] Merchants' Nat. Bank *v.* Richards, 6 Mo. App. 454; s. c. 74 Mo. 77; Moore *v.* Bank, 52 Mo. 379; Sibley *v.* Quinsigamond Nat. Bank 133 Mass. 515; Sargent *v* Essex Marine Ry. Co. 9 Pick. 201; Sergeant *v.* Franklin Ins. Co. 8 Ib. 90; Dickinson *v.* Central Nat. Bank, 129 Mass. 279; Boston Music Hall Association *v.* Cory, 129 Ib. 435; Fisher *v.* Essex Bank, 5 Gray, 373; German Union Building Assn. *v.* Sendmeyer, 50 Pa. St. 67; Strange *v.* Houston & T. R.R.Co. 53 Tex. 162; Manns *v.* Brockville Nat. Bank, 73 Ind. 243; Continental Nat. Bank *v.* Eliot Nat. Bank, 7 Fed. Rep. 369; N. O. Nat. Banking Assn. *v.* Wiltz, 10 Fed.Rep. 330; Driscoll *v.* West Bradley Manuf. Co. 59 N. Y. 96; Nahring *v.* Bank of Mobile, 58 Ala. 204; Broadway Bank *v.* McElrath, 13 N. J. Eq. 24: United States *v.* Vaughan, 3 Binn. 394; Commonwealth *v.* Watmough, 6 Whart. 138; Finney's App. 59 Pa. St. 308; Lane's App. 89 Ib. 411; Eby *v.* Guest, 94 Ib. 160; Fraser *v.* Charleston, 11 S. C. 519; Cornick *v.* Richards, 3 Lea, 1; Beckwith *v.* Burrough, 13 R. I. 294. Although under Gen. Stats. Mass. 1882, c. 133, §43, it is provided that the interest of any stockholder in any corporation organized under the authority of the State, may be taken on execution and sold, yet the Legislature has not defined what shall be an attachable interest in stock, but leaves it to be determined by the common law or some other statute. Boston Music Hall Assn. *v.* Cory, 129 Mass. 435; Sibley *v.* Quinsigamond Nat. Bank, 133 Ib. 515.

[2] Merchants' Nat. Bank *v.* Richards, 74 Mo. 77; s. c. 6 Mo. App. 454.

The holder for value, without notice, of certificates of stock, by indorsement of the power of attorney to transfer and delivery, and with notice to the company, possesses a right superior to that of a subsequent attaching creditor, although a valid by-law be embodied in the certificate that the stock is only transferable on the books of the company at its office upon surrender of the certificate, there being no provision in the charter.[1] Even with such provision in the charter, the equity of the bona fide holder advancing money thereon is preferred to that of a subsequent attaching creditor, whether with or without notice.[2] Stock of a national bank was held in trust, the certificate being indorsed absolutely to the real owner. The trustee continued to collect the dividends, paying them over to the real owner, and no transfer was made on the books of the company. An attempt was made to subject the stock to execution by a judgment creditor of the bare trustee, but was not supported, although the bank and the creditor were without notice of the trust.[3]

§ 294. PLEDGES OF STOCK, WITHOUT TRANSFER, SUPPORTED AS AGAINST CREDITORS.—A certificate of stock transferable according to its terms only by appearance in person or by attorney at the place mentioned therein, was indorsed in blank by the legal owner, and delivered to a third person who pledged the same to a bank as collateral security for a loan. The owner having deceased, a transfer of such certificate was made upon a subsequent filling up of the blank indorsement by the pledgee. As against an attachment of the shares by a creditor of the estate, the claims of the pledgee were preferred.[4] Notice of a pledgee's rights

[1] State Ins. Co. *v.* Gennett, 2 Md. Ch. 100; Stebbins *v.* Phœnix Fire Ins. Co. 3 Paige, 361; United States *v.* Vaughan, 3 Binn. 394.

[2] Duke *v.* Cahawba Navigation Co. 10 Ala. 82; State Ins. Co. *v.* Gennett, supra; Farmers' Bank *v.* Iglehart, 6 Gill, 50.

[3] Sibley *v.* Quinsigamond Nat. Bank, 133 Mass. 515.

[4] Fraser *v.* Charleston, 11 S. C. 486.

will defeat a levy by a creditor. A certificate of stock was pledged to an accommodation indorser as collateral with a blank power of attorney for making "the proper transfer on the books of the company." The indorser was obliged to pay the note. Another creditor of the accommodated party levied upon the stock before transfer upon the books of the company, but being chargeable with notice of the pledge, acquired no rights as against the pledgee.[1] So, where a creditor, upon his levy and execution, obtained a sale of shares of stock, the purchaser at the execution sale being chargeable with notice that the certificates were held by a pledgee for value, in good faith, properly indorsed, a court of equity protected the latter's title to the stock. The company had issued a new certificate to the purchaser at the execution sale, but the rights of the pledgee to a transfer could not be affected by an unauthorized act of the company.[2]

The pledgee of shares of stock in a corporation having the legal title and possession by indorsement of the certificates, has a lien superior to that of a levy under an execution; and a purchaser at a sheriff's sale, under such levy, acquires no title to the shares.[3] Nor can executions and attachments be levied on shares of stock in cases where the debtor has only an equitable right, or is not the legal possessor of the legal title, or has regularly indorsed his interest therein.[4] In Connecticut, where transfer of shares

[1] Cheever *v.* Meyer, 52 Vt 66. One hundred shares of stock were pledged as collateral security, with full power of transfer indorsed, but before transfer ten of the shares were attached by a creditor of the pledgor. The company then refused to transfer any of the shares to the name of the pledgee. Subsequently the same creditor, with notice of the pledge, attached the remaining ninety shares. The pledgee's rights as to the ninety shares were sustained against both the company and creditor. Warren *v.* Brandon Manuf. Co. reported in note to Cheever *v.* Meyer, supra.

[2] Rogers *v* Stevens, 8 N.J.Eq. 167.

[3] Manns *v.* Brookville Nat. Bank, 73 Ind. 243; Nahring *v.* Bank of Mobile, 58 Ala. 204.

[4] Van Norman *v.* Jackson, 45 Mich. 204.

of stock upon the books of the company is required by statute in order to pass the legal title as against third persons, so that, until transfer, the pledgee holds but an equitable title to the collateral stocks, the rule is modified so that the same considerations which excuse a failure to take possession of personal property excuse a failure to perfect the transfer of stock. The equity of the assignee of such certificates of stock if prior in time to that of the attaching creditor, prevails, where he has done all that the law required, and all that it is possible for him to do in taking possession of the property.[1]

§ 295. THE CREDITOR'S LIEN, AS AGAINST PLEDGEE, UNDER STATUTORY ENACTMENTS.—In states where statutory provisions requiring transfer on the books of the company to complete the legal title to shares of stock are supplemented by other enactments authorizing the issue of legal process against such stock, as being the property of the person in whose name it stands on the books of the company, the lien of the creditor is enforced. The failure of the pledgee, receiving the certificate with power of attorney, to make such transfer, defeats his claim as against such creditor, although the act of pledge be prior in point of time to the service of process. The creditor is authorized to rely upon the statements of ownership found in the stock books of the company.[2] Under this view it is insisted that if the indorsement and delivery of a certificate of stock to the pledgee be alone sufficient to defeat the claims of creditors of the

[1] Colt *v.* Ives, 31 Conn. 25.

[2] Fisher *v.* Essex Bank, 5 Gray, 373; Blanchard *v.* Dedham Gas Co. 12 Gray, 213; Oxford Turnpike Co. *v.* Bunnell, 6 Conn. 558; Dutton *v.* Connecticut Bank, 13 Ib. 498; Shipman *v.* Etna Ins. Co. 29 Ib. 251; Agricultural Bank *v.* Burr, 24 Me. 256; Skohegan Bank *v.* Cutter, 49 Me. 315; People *v.* Devin, 17 Ill. 86; People's Bank *v.* Gridley, 91 Ib. 457; Pinkerton *v.* Manchester Railroad Co. 42 N. H. 424; Pittsburgh Railroad Co. *v.* Clarke, 29 Pa. St. 146; Brown *v.* Kneeland, 5 Biss. 181; Williams *v.* Mechanics' Bank, 5 Blatchf. 59; Heath *v.* Erie Railroad Co. 8 Ib. 347; Bowden *v.* Farmers' & M. Bank, 1 Hughes, 307.

pledgor, the provisions of such statutes would be deprived of much of their practical utility, and the new certificate, the issuance of which to the purchaser at the judicial sale, is generally provided for in such statutes, would be a nullity and of no avail.[1] The bona fide purchaser at a sale made under such legal process, takes the legal title to such shares of stock as against the pledgee, holding the certificate by indorsement and delivery, but without a transfer on the books of the company as required by such statutory provisions.[2] Nor will a court of equity restrain a sale of the remaining interest of a pledgor of shares of stock levied upon under attachment process instituted by a creditor, where a pledgee of certificates representing such shares although holding them under indorsement of the power of attorney to transfer, had neglected to comply with statutory provisions. The duty of the pledgor was to attend at the sale and give notice of his interest therein.[3]

[1] People's Bank *v.* Gridley, 91 Ill. 457.

[2] Agricultural Bank *v.* Burr, 24 Maine, 263; Shipman *v.* Etna Ins. Co. 29 Conn. 253; Strout *v.* Natoma Co. 9 Cal. 78; Fisher *v.* Essex Bank, 5 Gray, 373; Cady *v.* Potter, 55 Barb. 467; Sabin *v.* Bank of Woodstock, 21 Vt. 353; Winter *v.* Belmont Mining Co. 53 Cal. 431; People *v.* Elmore, 35 Ib. 655; Naglee *v.* Pacific Wharf Co. 20 Ib. 533; Weston *v.* Bear Ridge etc. Co. 6 Ib. 425.

[3] Farmers' Bank *v.* Wilson, 58 Cal. 600.

CHAPTER XXX.

STOCK CERTIFICATES AS COLLATERAL.

§296. The use of stock certificates as collateral security.
297. The pledge of stock certificates, by trustees.
298. The pledge of stock certificates showing a trust.
299. The rule as to notice of trust.
300. The use of "trustee" in mining stock certificates.
301. The executor's right to pledge stock.
302. The executor's pledge of stock for his own debts.
303. Pledges of stock by and to banks and other corporations.
304. National banks as pledgees of stocks.
305. Pledges of stock by married women and minors.
306. The stockbroker, holding stocks, margins, and securities, a pledgee.
307. The stockbroker, holding stocks and margins, not a pledgee in Massachusetts.

§ 296. The use of Stock certificates as Collateral Security.—The use of certificates of stock as collateral security by persons holding the same in a fiduciary character, for advances or discounts of paper obtained at banks, is generally approved, where the transaction of loan upon the part of the lender is bona fide, without notice of any trust or other equities, and the certificates are received indorsed so as to pass the legal title. No rights can be acquired under such pledges of stock certificates where a trust is shown upon the face thereof, nor where from the circumstances the lender is chargeable with knowledge that the act of pledge is a misappropriation of securities of a trust estate for the individual use and benefit of the person holding the title to such securities upon trust. Under such circumstances, the certificates of stock may be recovered by the cestuis que

trust, or others in their behalf, or the proceeds thereof may be followed and reclaimed. Sub-pledgees of stock certificates held by a pledgee from trustees or other like persons, indorsed in blank, receiving them in good faith, upon a valuable advance made in the belief that the pledgee is the owner thereof, and without notice, may acquire a good title as against the cestui que trust, although the pledgee himself be chargeable with notice of fraud. The loan of money and discount of commercial paper, upon the security of certificates of stock of other corporations, is a common transaction among national and other banks and undoubtedly valid.[1]

§ 297. THE PLEDGE OF STOCK CERTIFICATES BY TRUSTEES.—A pledge by a trustee of an estate of certificates of stock belonging thereto, the certificates showing a trust upon their face, or where the pledgee is, in any other way, informed or charged with notice that the stock is subject to a trust, as collateral security for money loaned for his individual use, is a breach of trust. The cestuis que trust are entitled to follow the certificates of stock, and reclaim the same or the proceeds thereof where they have been converted into money, under the powers given by such invalid pledge.[2] Laches on the part of cestuis que trust in seeking relief from fraudulent transactions of trustees relative to stocks belonging to the trust estate, will not defeat their claims, although it has extended over forty-four years.[3] A

[1] First Nat. Bank *v.* Stewart, U.S. S. C. 1883 (15 C.L.N.429); Bank *v.* Case, 99 U. S. 628; Duncan *v.* Jaudon, 15 Wall. 165; Jaudon *v.* National City Bank, 8 Blatchf. 430; Goodwin *v.* American Nat. Bank, 48 Conn. 550; Winter *v.* Belmont Mining Co. 53 Cal. 428; Carter *v.* National Bank, 71 Me. 448; Baldwin *v.* Canfield, 26 Minn. 43; Leitch *v.* Wells, 48 N. Y. 585; Wood's App. 92 Pa. St. 379; Persch *v.* Consolidation Nat. Bank, 13 Phila. 157; Prall *v.* Tilt, 28 N. J Eq. 479; Gass *v.* Hampton, 16 Nev. 185; Shropshire Unions Ry. Co *v.* Queen, L. R. 7 App. 496; Pearson *v.* Scott, L. R. 9 Ch. D. 198; McLeod *v.* Drummond, 17 Ves. 154.

[2] Jaudon *v.* Nat. City Bank, 8 Blatchf. 430.

[3] Butler *v.* Carter, L. R. 5 Eq. 276; Burrows *v.* Gore, 6 H. L. Cas. 907.

pledge of stocks of the estate by a trustee is not within the ordinary course of business, as a trustee presumptively holds the property for administration; and although the consideration be a present loan, and the pledgee acts in good faith, he receives such certificates of stock as collateral security at his peril.[1] As does also a pledgee where such certificates of stock are delivered to secure the payment of an indebtedness arising from an independent transaction not connected with the trust, and of which the pledgee is chargeable with notice.[2]

No presumption as against such cestuis que trust arises from the fact that the trustees have been entrusted with muniments of title, such as certificates of stock. Such possession is within ordinary and permitted usage. The cestuis que trust, by such delivery, do not forfeit their title and interest in such certificates.[3] Certificates of stock indorsed with full power to transfer and delivered to A as trustee, were fraudulently loaned to B, a broker, upon certain compensation, to be used as collateral. A pledgee of the stocks sold them upon default, but could not complete the legal transfer by reason of a notice not to transfer, and an indemnity given by the cestui que trust to the corporation. The pledgee recovered from the corporation the value of the stock at the time of refusal to transfer, a sum which with the proceeds of other collateral securities held for the same loan, exceeded the amount of the principal loan. As both the broker and trustee were parties to the fraud, the surplus was equitably appropriated in mitigation of the damages paid by the corporation.[4]

§ 298. THE PLEDGE OF STOCK CERTIFICATES SHOWING A TRUST.—The word "trustee," without more, in a certificate of stock has the same effect as to charging persons dealing

[1] Duncan *v.* Jaudon, 15 Wall. 165, 175.

[2] Prall *v.* Tilt, 28 N. J. Eq. 479; Duncan *v.* Jaudon, supra.

[3] Shropshire Unions Ry. Co. *v.* Queen, L. R. 7 App. 496, 516.

[4] Persch *v.* Consolidation Nat. Bank, 13 Phila. 157.

therewith with notice as if it were specifically stated "trustee for X," designating some certain person or persons. It means trustee for some one whose name is undisclosed. No presumption arises in such case of an unnamed cestui que trust that a trustee is authorized to pledge for his own debt the certificates of stock of the beneficiary any more than in the case of pledge of the like property of a cestui que trust whose name is known. In either case an implication arises charging the pledgee with notice of the trust. Should a pledgee receive such certificates as collateral security without inquiry as to the purpose of the loan his negligence will in cases of breach of trust, defeat his title.[1] The pledgee acts especially at his peril where he advances money without inquiry upon a certificate of stock which shows upon its face the name of a cestui que trust. In such cases the transfer agent of the company, upon a transfer being sought by the pledgee, should require an authority to transfer independent of the warrant of attorney indorsed upon the certificate itself.[2] Where a corporation transfers such stock upon its books, issuing a new certificate to a bona fide person advancing value, without notice, although there be no right to make the transfer, the title of such innocent person is protected, the defrauded cestuis que trust being entitled to damages as against the corporation for its wrong-

[1] Shaw *v.* Spencer, 100 Mass. 382; Fisher *v.* Brown, 104 Ib. 259; Fowle *v.* Ward, 113 Ib. 548; Atkinson *v.* Atkinson, 90 Ib. 15; Ashton *v.* Atlantic Bank, 3 Allen, 217; Field *v.* Schieffelin, 7 Johns. Ch. 150; Pendleton *v.* Fay, 2 Paige, 202; Budd *v.* Monroe, 18 Hun, 316; Swan *v.* Produce Bank, 24 Ib. 277; Crocker *v.* Crocker, 31 N. Y. 507; Baker *v.* Bliss, 39 N. Y. 70; Gaston *v.* American Bank, 29 N. J. Eq. 98; Bayard *v.* Farmers' Bank, 52 Pa. St. 232; Sprague *v.* Cocheco Manf. Co. 10 Blatchf. 173; Carr *v.* Hilton, 1 Curtis, 390; Lowry *v.* Commercial Bank, Campbell, 310; Duncan *v.* Jaudon, 15 Wall. 165; Bank of Metropolis *v.* New England Bank, 6 How. 212; McLeod *v.* Drummond, 17 Ves. 152; Fish *v.* Kempton, 7 C. B. 687; Brandao *v.* Barnett, 1 M. & G. 908; 6 M. & G. 630; 12 Cl. & Fin. 787.

[2] Duncan *v.* Jaudon, 15 Wall. 165; Jaudon *v.* National City Bank, 8 Blatchf. 430; Bayard *v.* Farmers' Bank, 52 Pa. St. 232; Maygood *v.* Railroad Bank, 5 S. C. 379.

ful transfer.[1] A loan by a bank void by reason of statutory provisions, is not sufficient to support a pledge of stock, standing on the books of the corporation in the name of a "trustee," and used by such trustee as collateral security. The invalidity of the principal debt destroys the claim of the lender, if any, upon the collateral securities given for its payment.[2]

§ 299. THE RULE AS TO NOTICE OF TRUST.—The rule as to the implied notice resulting from the use of the word "trustee," was applied where an owner of shares employed a stockbroker to borrow money upon a pledge thereof. The broker pledged the shares as collateral to another broker for a loan of the sum required and for an old debt of his own, giving a borrowed and received memorandum payable on demand, and signing himself "trustee." The owner, learning of the transaction, tendered the amount of the loan, and demanded a return of the certificate. The pledgee refused to recognize his claim, but subsequently returned sixty out of the eighty shares upon a proportionate payment, the other shares having been sold. A bill in equity to redeem the remaining shares was brought by the owner. The nature of the transaction being sufficient of itself to charge the pledgee with knowledge that the borrower was acting as the agent of an undisclosed principal, no claim could arise as to any sum beyond the amount actually authorized and advanced, the rule of damages, the sale of the shares being unauthorized, being the value thereof at the time of the commencement of the suit.[3] A broker on the London Stock Exchange employed to sell securities and invest the proceeds in stocks, but chargeable with notice that such securities belonged to a trust fund, sold the same, paying the

[1] Maygood *v.* Bank and Bayard *v.* Bank, supra.

[2] Albert *v.* Savings Bank, 2 Md. 159; Brewster *v.* Simes, 42 Cal. 139; Thompson *v.* Tolland, 48 Ib. 99; Gass *v.* Hampton, 16 Nev. 185; Winter *v.* Belmont Mining Co. 53 Cal. 428.

[3] Fowle *v.* Ward, 113 Mass. 548.

proceeds into his own account, and then bought the stock as ordered. Before settling day, the broker became insolvent, and the stocks were never delivered. The trustee was allowed to recover so much of the broker's balance as represented the value of the securities.[1] A stockbroker, employed by a solicitor of trustees to sell stocks on the exchange, and having notice that such stocks belonged to a trust estate, is not allowed to apply part of the proceeds thereof to the credit of the solicitor upon a personal account.[2]

A banker of a railway company, and one of its directors, was entrusted, under a business arrangement, with certificates of stock as trustee. Some of the certificates were used as collateral security by him, but no transfer was made by the pledgee. After his death, the pledgee's representatives sought by a mandamus to compel registration by the company, but the issue of the writ was refused upon the ground that it was the ordinary case of a trustee abusing his trust, and that, receiving only an equitable mortgage of the shares, the pledgee should have inquired as to the title of the pledgor, and failing so to do, his claim would not be preferred to that of the original cestuis que trust, although no trust was shown upon the face of the certificates.[3]

§ 300. The use of "Trustee" in Mining stock certificates.—A custom prevails in California, Nevada, and other mining states, in connection with mining stocks certificates, to issue the same in the names of persons "as trustees," without any trust in fact existing. The title to such stocks pass by delivery merely. No presumption arises, by reason of the use of the words as "trustee" on the face of the certificate that the person using the same as collateral has not the legal title thereto, nor is not entitled to dispose

[1] Ex parte Cook, L. R. 4 Ch. D. 123; Taylor *v.* Plummer, 3 M. & S. 562.

[2] Pearson *v.* Scott, L. R. 9 Ch. D. 198.

[3] Shropshire Unions Ry. Co. *v.* Queen, L. R. 7 H. L. 496.

of the same as his own individual property. Such certificates, so worded, do not sustain a charge of notice of any actual trusteeship, nor of the rights of an unknown cestui que trust, as against a pledgee for value in good faith.[1] An innocent holder advancing value without notice, upon the faith of a certificate of stock of a mining company made to A. "as trustee," which had been returned to the true owner by A, and was subsequently stolen from him by A, and negotiated for value, was protected as against the real owner, notice not being presumed by the wording of the certificate, nor the title of such holder for value affected thereby.[2]

§ 301. The Executor's right to pledge Stocks of the estate.—The right of an executor, in the absence of restrictive provisions in the will and testament of the testator, to deal with the personal assets of the estate in his charge, either by way of sale, mortgage, or pledge, for purposes connected therewith, is unquestioned. The right includes the use as collateral security of certificates of stock standing in the name of the testator for loans obtained to pay legacies under the will.[3] The rights of the pledgee, receiving stock so pledged in good faith, are not affected by knowledge that the executor is dealing with such assets in a fiduciary character, since such fact is not of itself enough to put him upon inquiry, nor to raise a suspicion of fraudulent conduct on the part of the executor.[4] Knowledge of the pledgee of

[1] Brewster *v.* Simes, 43 Cal. 139; Thompson *v.* Tolland, 48 Ib. 99; Gass *v.* Hampton, 16 Nev. 185.

[2] Winter *v.* Belmont Mining Co. 53 Cal. 428.

[3] Carter *v.* National Bank, 71 Me. 448; Hutchins *v.* State Bank, 12 Met. 423; Ashton *v.* Atlantic Bank, 3 Allen, 217; Field *v.* Schieffelin, 7 Johns. Ch. 150, 160; Jaudon *v.* City Bank, 8 Blatchf. 430; Goodwin *v.* American Nat. Bank, 48 Conn. 550; McLeod *v.* Drummond 17 Ves. 154; Scott *v.* Tyler, 2 Dick, 712, 725; Andrew *v.* Wrigley, 4 Br. Ch. Cas. 125; Russell *v.* Plaice, 18 Beav. 21; Cruikshank *v.* Duffin, L. R. 13 Eq. 555; Earl Vane *v.* Rigden, L. R. 5 Ch. 663. A contrary view is announced in Ford *v.* Russell, 1 Freem. Eq. (Miss.) 42.

[4] Prall *v.* Tilt, 28 N. J. Eq. 479; Bayard *v.* Farmers' Bank, 52 Pa. St. 232; Jaudon *v.* Bank, 8 Blatchf. 430.

the existence of valid claims upon the funds and securities of the estate, will not discharge his claims.[1] Nor is the pledgee required to see to the application of funds loaned, nor responsible for the misappropriation thereof, where he has acted in good faith.[2] But such pledge of stocks is not supported where made so long a time after the death of the testator that a presumption arises that all debts have been paid and that funds to be raised on collateral security cannot be required for the use of the estate.[3]

§ 302. The Executor's pledge of Stocks for his own debts.—An executor, however, can not make a valid transfer of stocks belonging to the estate as collateral security for his own debts or obligations, or to procure the discount of his own notes at a bank or broker's office. In such cases the money being procured for his private use, and the pledgee chargeable with notice thereof, the transfer of the stock is a devastavit, and no rights can be acquired thereunder.[4] A pledgee who is chargeable with knowledge or has reasonable grounds for believing that an executor intends to misapply the funds loaned, or that an executor is in the very transaction applying such funds to his own private use, is chargeable to the persons injured for any loss thus sustained.[5] Where such misappropria-

[1] Leitch *v.* Wells, 48 N Y. 585.

[2] Stinson *v.* Thornton, 56 Ga. 377; Leitch *v.* Wells, 48 N. Y. 585; Wood *v.* Smith, 92 Pa. St. 379; Goodwin *v.* Bank, 48 Conn. 550.

[3] Bellas *v.* McCarty, 10 Watts, 73; Miller *v.* Ege, 8 Pa. St. 352; Lowry *v.* Commercial Bank, Campbell, 310; Collinson *v.* Lister, 7 DeG. M. & J. 634.

[4] Wood's App. 92 Pa. St. 379, 391; Duncan *v.* Jaudon, 15 Wall. 176; Carter *v.* Nat. Bank, 71 Me. 448; Davis *v.* French, 20 Ib. 21; Hill *v.* Simpson, 7 Ves. 152; Haines *v.* Forshaw, 11 Hare, 93; Wilson *v.* Moore, 1 M. & K. 337; Miles *v.* Dumford, 2 Sim. N. S. 233.

[5] Lowry *v.* Commercial Bank, Campbell, 310 330; Yerger *v.* Jones, 16 How. 30, 37; Collinson *v.* Lister, 7 DeG. M. & G. 633. Certificates showing upon their face that they were the property of an estate, were received by the pledgees directly from executors, but as security for a debt owing by a son of the testator, who made no claim to own the stock. It was the duty of the pledgee to ascertain whether there was any

tion was rendered possible by the negligence of a corporation permitting a transfer of stock by executors, and new certificates subsequently passed into the hands of pledgees for value, without notice, for a private debt of the executors, and were sold, under a power of sale, the company, by reason of its gross negligence, became liable for the loss to the estate resulting therefrom.[1]

The rules of equitable estoppel are invoked in favor of sub-pledgees of certificates of stock, although the same were originally fraudulently pledged by an executor for his own debt. The delivery of such certificates indorsed in blank, so as to vest the legal title and apparent ownership in the pledgee, enables the latter, although chargeable with notice of equities, to convey an unimpeachable title to a sub-pledgee, receiving the same in good faith, for value, without notice of equities. The latter is entitled to retain such collateral securities, even as against the defrauded cestuis que trust, until the payment of his bona fide advances.[2]

§ 303. Pledges of Stock by and to Banks and other corporations.—In the absence of any restriction by statutory enactment, or by its charter, a banking company may loan money, or discount commercial paper, or secure an antecedent debt, upon a deposit as collateral se-

right so to transfer the stock. Their negligence defeated their claim. Prall *v.* Hamill, 28 N. J. Eq. 66.

[1] Hodges *v.* Planters' Bank, 7 G. & J. 306; Stewart *v.* Farmers' Ins. Co. 53 Md. 564; Lowry *v.* Commercial Bank, supra; Davis *v.* Bank of England, 2 Bing. 393. The like rule was applied where a certificate of stock was wrongfully issued to executors by the corporation sought to be charged in the action, and a bank loaned money thereon as collateral security, receiving full power of attorney to transfer, and sold the certificate, under a right of sale given by the contract of pledge, without knowing at any time that the stock had belonged to the testator or had been transferred to the executor. The title of both pledgee and purchaser were supported, as against equities arising under the will. Lowry *v.* Commercial Bank, Campbell, 310.

[2] Wood's App. 92 Pa. St. 379; Prall *v.* Tilt, 28 N. J. Eq. 480.

curity of certificates of stock issued by other corporations. It is in fact an ordinary mode of loaning money, the security being easily available upon default in the principal promise.[1] A banking company, holding such certificates of stock, with power of attorney to transfer indorsed, obtaining for its better protection transfer upon the books of the company, and receiving a new certificate in its own name, becomes a stockholder thereof, subject to like liabilities as any other stockholder. Where this has been done, and dividends accruing upon such stock also received, a banking company or any other corporation is estopped as against third persons, to deny its liability as stockholder, the company issuing the shares having gone into liquidation.[2] The defense of ultra vires is not permitted to a corporation as against an innocent holder for value of negotiable instruments, receiving the same before maturity, without notice, issued in payment of shares of stock of another company. The note being an independent transaction, recovery may be had thereon.[3] Even where a corporation is prohibited by charter or statutory provisions, from loaning money on such collaterals, a pledge of certificates of stock of another corporation is rather voidable than void. The rights and interests of third persons accruing thereunder are not defeated by any inequitable defense of ultra vires.[4] The pledgor himself, having received the loan, is not allowed to set up the alleged invalid character thereof to defeat an action upon the note given for the advance.[5] The title of the pledgee of stocks is not defeated where he holds the

[1] National Bank *v.* Case, 99 U. S. 628; Shoemaker *v.* National Mechanics' Bank, 2 Abbott, 416; Dayton Nat. Bank *v.* National Bank, 37 Ohio St. 208; National Bank *v.* Hall, 18 Hun, 176; Baldwin *v.* Canfield, 26 Minn. 43.

[2] In re Asiatic Bank Co. L. R. 7 Eq. 91; s. c. 4 Ch. 22.

[3] Wright *v.* Antwerp Pipe Co. 101 Penn St. 204. The same rule was applied in Oil Creek etc. Ry Co. *v.* Penn. Transportation Co. 83 Pa. St. 160; Northampton Co.'s App. 30 Ib. 605; Lestapies *v.* Ingraham, 5 Ib. 81.

[4] Sistare *v.* Best, 88 N. Y. 527.

[5] Mott *v.* United States Trust Co. 19 Barb. 568.

same under a contract containing a stipulation of the invalidity of which he has no knowledge or notice.[1]

A corporation may issue its own unsubscribed and unissued shares of stock as collateral security for advances already made and made at the time, or they may be held by a third person in trust for that purpose. Where statutes have been enacted relieving pledgees of stock from responsibility as stockholders, the fact that such shares of stock are held as collateral security is sufficient to bring the pledgees thereof within the rule.[2] Pledges to a bank of its own stock were sustained as against a statutory provision that no bank should make any loan or discount on a pledge of its own stock, where the loans were made on the personal security of the stockholder, who had previously pledged his stock to the bank for his "future indebtedness and liability."[3]

§ 304. National Banks as pledgees of Stocks.—A national bank may take certificates of stock issued by another corporation, with a power of attorney indorsed thereon, as collateral security for a loan or discount of commercial paper. No provision of the National Bank Act prohibits such transactions.[4] Nor is the rule affected by the fact that real estate constitutes the whole property of a corporation issuing such shares of stock used as collateral security.[5] The National Bank Act, however, directly prohibits the making of present loans or discount of commercial paper, upon a pledge of certificates of stock issued by itself, although where the receipt of such securities is to prevent loss on a debt previously contracted, the act of pledge is

[1] Curtis *v.* Leavitt, 15 N. Y. 9.

[2] Burgess *v.* Seligman, 107 U. S. Rep. 20; Matthews *v.* Albert, 24 Md. 527. Such a pledge, the shares being placed in the name of a trustee, was supported in re City Terminus Hotel Co. L. R. 14 Eq. 10. Contra: Brewster *v.* Hartley, 37 Cal. 15.

[3] VanSands *v.* Middlesex Co. Bank, 26 Conn. 144, 159; Conant *v.* Seneca Bank, 1 Ohio St. 298.

[4] National Bank *v.* Case, 99 U. S. 628.

[5] Baldwin *v.* Canfield, 26 Minn. 43, 62.

valid.[1] A borrower of money from a national bank who deposits certificates of shares of stock issued by such bank as collateral security, is chargeable with knowledge of the provisions of the National Bank Act. His claim to recover the stock, or the proceeds of its sale, while still retaining the avails of the loan, is not favored. Both parties being equally affected by the illegality of the transaction, under the prohibitions of the Bank Act, the aid of courts will not be given to either, especially where the contract of pledge has been executed, the stock sold, and the proceeds applied in payment of the debt.[2]

[1] Bank *v.* Lanier, 11 Wall. 369; Johnston *v.* Laflin, 103 U. S. 800. U. S. Rev. Stats. 1878, §5201, provides that "no association shall make any loan or discount on the security of the shares of its own capital stock, nor be the purchaser or holder of any such shares, unless such security or purchase shall be necessary to prevent loss upon a debt previously contracted in good faith, and stock so purchased or acquired shall, within six months from the time of its purchase, be sold or disposed of at public or private sale, or in default thereof a receiver may be appointed to close up the business of the association." The rule is applied to other banking corporations. State of Ohio *v.* Franklin Bank, 10 Ohio, 91; Taylor *v.* Miami Exp. Co. 6 Ham. 176; Farmers' Bank *v.* Champlain Trans. Co. 18 Vt. 131; Marine Bank *v.* Biays, 4 H. & J. 338; Franklin Bank *v.* Commercial Bank, 36 Ohio St. 350. A pledge to a corporation of its own shares of stock was sustained in Middlesex Bank *v.* Minot, 4 Met. 325; ex parte Holmes, 5 Cow. 426; Butterworth *v.* Kennedy, 5 Bosw. 143.

[2] First National Bank of Zenia *v.* Stewart, 107 U. S. (17 Otto) 676. The Supreme Court considering §5201 of Rev. Stats. 1878, say (Field, Jus.): "While this section in terms prohibits a banking association from making a loan upon the security of shares of its own stock, it imposes no penalty, either upon the bank or borrower, if a loan upon such security be made. If, therefore, the prohibition can be urged against the validity of the transaction by any one except the Government, it can only be done before the contract is executed, while the security is still subsisting in the hands of the bank. It can then, if at all, be invoked to restrain or defeat the enforcement of the security. When the contract has been executed, the security sold, and the proceeds applied to the payment of the debt, the courts will not interfere with the matter. Both bank and borrower are in such case equally the subjects of legal censure, and they will be left by the courts where they have placed themselves.

There is another view of this case. The deceased authorized the bank,

§ 305. Pledges of Stock by Married women and Minors.—Pledges of stock by indorsement and delivery of the certificate, made by married women are supported, although the loan to secure which such shares have been deposited as collateral security, be for the benefit of the husband, and not applied for necessaries, nor the improvement of the separate estate of the wife.[1] A pledge of certificates of stock by a married woman, as "security for the payment of any demands you may from time to time have or hold against" her husband, will cover future advances made bona fide.[2] A pledgee for value, upon default, was proceeding to sell certificates of stock pledged by a married woman, who filed a bill in equity to restrain the sale and compel return of the certificate, but made no payment or tender of the debt. She was in fact unable to restore the consideration for which the pledge was given. The fraud of permitting her, under such circumstances, to recover from a bona fide pledgee the substantial security on which he had parted with his money, is not permitted or tolerated in a court of equity.[3]

The disabilities attaching to persons under age, renders pledges of stocks as collateral security for illegal speculations upon margins by stockbrokers absolutely void. Such deposits of stocks and margins by a minor to secure a stockbroker against losses on account of proposed options and

in a certain contingency, to sell his shares. Supposing it was unlawful for the bank to take those shares as security for a loan, it was not unlawful to authorize the bank to sell them when the contingency occurred. The shares being sold pursuant to the authority, the proceeds would be in the bank as his property. The administrators, indeed, affirm the validity of that sale by suing for the proceeds. As against the deceased, however, the money loaned was an offset to the proceeds. In either view the administrators can not recover."

[1] Merchants' National Bank *v.* Hall, 83 N. Y. 338; Dando's App. 94 Pa. St. 76.

[2] Merchants' National Bank *v.* Hall, supra.

[3] Dando's App. 94 Pa. St. 76; Selden *v.* National Bank, 69 Ib. 424; Fryer *v.* Rishell, 84 Ib. 521; Hinney *v.* Phillips, 50 Ib. 382.

purchases and sales, are not supported, although the broker be unaware of the minority of his customer. A minor is allowed upon coming of age, to avoid such contracts, and may recover his stock securities and money advanced as margins, even without returning the consideration received, if any.[1] The same rule applies to contracts made by minors under which deposits of money are made with a broker for the purchase of stocks upon illegal contracts. Where such stocks are never delivered, and a pretended sale is made without notice or demand of payment, under a power to sell at public or private sale, the minor may repudiate the contract and recover his deposit of collaterals.[2]

§ 306. The Stockbroker, holding stocks, margins, and securities, a Pledgee.—The contract of the stockbroker and his customer where, upon an order from the customer, and the deposit of collateral securities and margins, or margins alone, the broker purchases stocks for the customer, advancing a large proportion of the funds necessary therefor, upon an agreement to carry the same, the customer having the right at any time during the option, upon payment of the advances of the broker, interest and commissions, to demand a delivery of the stock, or to require its sale, and the broker having a power of sale upon default in furnishing margins as agreed, and reasonable notice of sale, or upon failure, at the expiration of the option, to pay the funds advanced to purchase such stocks held as security, is within the definition of a pledge. If the purchase of stock by a broker for a customer were completed by an immediate delivery of the stock to the latter, to be followed by a re-delivery thereof to the broker as collateral to secure the payment of his advances, commissions, and interest, there would be a compliance with the technicalities of an act of pledge. The

[1] Ruchizky *v.* DeHaven, 97 Pa. St. 202.

[2] Heath *v.* Mahone, 24 Hun, 341.

intention of the parties to the contract may, however, be presumed from the retention of the shares by the broker in his character as pledgee, as showing a waiver of the form of delivery and re-delivery.[1]

This view of the relations of the broker and customer is supported by the terms of the usual contract between the parties. The broker agrees: 1. At once to buy for the customer the stocks he desires. 2. To advance all the money required for the purchase beyond the ten per cent., or other margin furnished by the customer. 3. To carry or hold such stocks for the benefit of the customer so long as the margin of ten per cent., or other margin, is kept good, or until notice is given by either party that the transaction must be closed—an appreciation in the value of the stocks being the gain of the customer and not of the broker. 4. At all times to have in his name, or under his control and ready for delivery the shares purchased, or an equal amount of other shares of the same stock. 5. To deliver such shares to the customer when required by him, upon the receipt of the advance and commissions accruing to the broker. 6. To sell such shares upon the order of the customer upon the payment of the like sums to him, and account to the customer for the proceeds of such sale. The undertaking of the customer is: 1. To pay a certain margin on the current market value of the shares. 2. To keep good such margin according to the fluctuations of the market. 3. To take the shares so purchased on his order whenever required by the broker, and to pay the difference between the percentage

[1] Baker *v.* Drake, 53 N. Y. 211; s. c. 66 Ib. 518; Stenton *v.* Jerome, 54 Ib. 480; Lawrence *v.* Maxwell, 53 Ib. 19; Horton *v.* Morgan, 19 Ib. 170; Markham *v.* Jaudon, 41 Ib. 235; Morgan *v.* Jaudon, 40 How. Pr. 366; Gruman *v.* Smith, 81 N. Y. 25; McNeil *v.* Tenth Nat. Bank, 40 Barb. 59; s. c. 46 N. Y. 325; Capron *v.* Thompson, 86 N. Y. 418; Nourse *v.* Prune, 4 Johns. Ch. 490; s. c. 7 Ib. 69; Wynkoop *v.* Leal, 64 Pa. St. 361; Esser *v.* Linderman, 71 Ib. 76; Diller *v.* Brubaker, 52 Ib. 498; Gilpin *v.* Howell, 5 Ib. 41; Child *v.* Hogg, 41 Cal. 519; Hatch *v.* Douglass, 48 Conn. 116; Maryland Fire Ins. Co. *v.* Dalrymple, 25 Md. 242; Baltimore Marine Ins. Co. *v.* Dalrymple, 25 Ib. 269.

advanced by him and the amount paid therefor by the broker.[1]

§ 307. The Stockbroker holding margins not a pledgee, in Massachusetts.—In Massachusetts, the transaction in which a broker advances money to purchase certificates of stock for a customer, the rule being the same where the customer advances money as a margin upon giving an order to buy, and to hold and carry such stocks for the customer, upon an agreement that the latter shall pay interest on the sums advanced, and in case the value of the stock depreciates, keep his margins good to a certain percentage of the current market value, is regarded as an executory or conditional contract, to deliver so many shares on the payment of so much money. The broker mainly furnishing the funds to purchase the stock is entitled, where he holds, as is generally the custom, such certificate of stock in his own name, having the legal title and possession, so long as no payment or tender of his advances, interest and charges is made, to use such stock as collateral for his own obligation. Nor does he become by such pledge liable to an action by his customer for conversion, as the latter has no right to its possession until payment.[2] The broker may sell the stock, without notice to his customer, where purchased chiefly with his own money, and while carrying the same a depreciation occurs in its value, and the customer fails to furnish further margins upon demand.[3]

[1] Markham *v.* Jaudon, 41 N. Y. 239 (Hunt, C. J.)

[2] Wood *v.* Hayes, 15 Gray, 375.

[3] Covell *v.* Loud, 135 Mass. 41.

CHPTER XXXI.

PLEDGE OF FORGED, FICTITIOUS, AND MISAPPROPRIATED STOCKS.

§308. The transfer of certificates of stock, under forged indorsements.
309. The rights and remedies of the real owner.
310. Rights of innocent holder, for value, of new certificate.
311. The title acquired under fraudulent issues of fictitious stock.
312. Estoppel in pais, as applied against corporations.
313 Equitable estoppel, as enforced in National Bank *v.* Watsontown Bank.
314. Equitable estoppel, as applied to the terms of certificates.
315. Estoppel of real owner, by blank indorsement of certificates.
316. The misappropriation of stock certificates by brokers and agents.
317. Essential conditions of pledge under misappropriation and fraud.
318. Measure of damages in cases of forgery and spurious stock.

§ 308. THE TRANSFER OF CERTIFICATES OF STOCK UNDER FORGED INDORSEMENTS.—No rights can be acquired directly under an act of forgery. Where a valid certificate of stock has been transferred by one not its owner, but having possession thereof, by the forgery of the name of the owner to the blank power of attorney to transfer, the person receiving such transfer, or acquiring any claim upon such stock, by or through such forgery, acquires no title or right therein as against any one lawfully claiming the same. It is immaterial that the corporation has assumed in good faith to issue a new certificate upon the forged indorsement of the old, so long as the new certificate remains in the hands of the person obtaining the transfer. The rule is different, however, where such new certificate of stock has passed into the hands of a bona fide holder, advancing value upon the credit of the representations contained

therein, without notice of equities. The rules of equitable estoppel are invoked in favor of such innocent holder for value, as against the corporation issuing such certificate, although it may be required to issue other shares of stock to the real owner, or pay him the value of the stock wrongfully transferred. No estoppel arises as against the company, to show the facts, so long as the new certificate remains in the hands of a pledgee of it, holding the same as a bare trustee, the debt for which the stock was given as collateral security having been paid. Nor will the fact that the person so holding may have sustained a loss or missed a benefit thereby, affect the refusal to apply the rules of estoppel in such case.[1] A holder for value of the new certificate chargeable with knowledge of the forgery or invalidity, can acquire no valid title as against the company.[2] Where a company is estopped to set up the facts as against a bona fide pledgee for value, without notice, holding new certificates, and has been required to replace the shares or their value at the suit of the real owner, it may bring an action at law against the person at whose request upon the presentation of the forged certificates, the new issue of certificates was made.[3]

§ 309. The rights and remedies of the real Owner.—An owner of shares of stock cannot, where free from negligence or bad faith, be deprived of them by a forgery of his name, or of any other material part of the power of attorney to transfer indorsed thereon. If by reason of

[1] Hilyard *v.* South Sea Co. 2 P. Wms. 76; Ward *v.* Central R.R. Co. 37 Geo. 515; Hambleton *v.* Cent. Ohio Ry. Co. 44 Md. 551, in which case dividends were paid to the pledgee on the stock after the forgery had been discovered. Simm *v.* Anglo-American Tel. Co. L. R. 5 Q. B. D. 188.

[2] Hambleton *v.* Central Ohio Ry. Co. 44 Md. 551; Pratt *v.* Machinists' Nat. Bank, 123 Mass. 110; Denny *v.* Lyon, 38 Pa. St. 98; Johnston *v.* Renton, L. R. 9 Eq. 181; Cottam *v.* Eastern Counties' Rys. 1 Johns. & H. 243; Taylor *v.* Great Indian Peninsular Ry. 4 DeG. & J. 559.

[3] Mechanics' Nat. Bank *v.* Field, 126 Mass. 345.

such forgery an apparently legal title to such shares of stock is vested in a third person, and the company upon the presentation of such forged indorsement, assumes to issue a new certificate thereon, the rights of the real owner are not affected.[1]

Where new certificates have been issued by the company upon such forged indorsement, the owner may proceed by bill in equity, praying for the issue of new certificates to himself, and his reinstatement as stockholder, or a decree may be entered for the value of the stock at the time of the demand, with dividends.[2] Relief may be sought in equity against the transferee of the new certificates, requiring a restoration thereof, and leaving the transferee to his remedy against the company.[3] But, upon a bill in equity against both a company and transferees of the stock, and decree that the company should issue new certificates to the owner, the rights of the two co-defendants, as between themselves, were not decided.[4] The owner has his action at law against the person participating in such unauthorized transfer[5] and

[1] Pollock *v.* Nat. Bank, 7 N. Y. 274; Sewall *v.* Boston Water Power Co. 4 Allen, 277; Pratt *v.* Machinists' Nat. Bank, supra; Telegraph Co. *v.* Davenport, 97 U. S 369; Davis *v.* Bank of England, 2 Bing. 393, 407; Ashby *v.* Blackwell, 2 Eden, 299; s. c. Ambl. 503; Sloman *v.* Bank of England, 14 Sim. 475; Bank of England *v.* Parsons, 5 Ves. 665, 669; Hartga *v.* Bank of England, 3 Ves 55.

[2] Telegraph Co. *v.* Davenport, 97 U. S. 369; Sewall *v.* Boston Water Power Co. 4 Allen, 277; Pratt *v.* Machinists' Nat. Bank, 123 Mass. 110; Lowry *v.* Commercial Bank, Taney's Dec. 310; Pollock *v.* National Bank, 7 N. Y. 274; Baltimore *v.* Ketchum, 57 Md. 23; Chew *v.* Bank of Baltimore, 14 Md. 199; Strange *v.* Houston & T. Ry. Co. 53 Tex. 162; Midland Ry. Co. *v.* Taylor, 28 Beav. 287; s. c. 8 H. L. Cas. 751; Davis *v.* Bank of England, 2 Bing. 393; Dalton *v.* Midland Ry. Co. 12 C. B. 458; Swan *v.* N. B. Australian Co. 7 H. & N. 603; s. c. 2 H. & C. 175; Duncan *v.* Luntby, 2 McN. & G. 30; Sloman *v.* Bank of England, 14 Sim. 475; Ashby *v.* Blackwell, 2 Eden, 299; and where it cannot issue any new shares, the company should be required to pay the value of the stock. Pollock *v.* National Bank, supra.

[3] Weaver *v.* Barden, 49 N. Y. 286.

[4] Pratt *v.* Mechanics' Nat. Bank, 123 Mass. 110; Sewall *v.* Boston Water Works Co. 4 Allen, 277.

[5] Sewall *v.* Boston Water Works Co., supra.

as against the company, for his loss.[1] Neither the absence of blame on the part of the officials of a company, in making an unauthorized transfer, nor the bona fides of a purchaser of certificates stolen from the owner, is a defense to a demand and suit by the real owner.[2]

§ 310. Rights of innocent Holder for value of new Certificate.—The title of a bona fide holder for value, by proper indorsement, of a new certificate of stock issued by a corporation upon a forged indorsement, or of a new certificate of stock, properly indorsed, issued in place of a stolen certificate, receiving the same without notice, and for a valuable consideration advanced upon the faith and credit thereof, is free from the infirmities of his transferrer. Such transferree is not bound to look beyond the certificate, or to ascertain the validity of the transfer from the books of the company. Holding such new certificate, he has a title by equitable estoppel as against the company, not from the person perpetrating the fraud, but as having acted upon the statements and representations of the company in issuing such new certificate.[3] As between himself and the company, such bona fide holder for value is not required, upon proceedings in equity, to surrender the shares issued to him, although by reason of obedience to other decrees requiring the issue of new shares to the real owner, the corporation has issued a greater amount of capital stock than authorized by its charter.[4]

[1] Midland Ry. Co. *v.* Taylor, 28 Beav. 287; s. c. 8 H. L. Cas. 751.

[2] Telegraph Co. *v.* Davenport, 97 U. S. 369.

[3] Lowry *v.* Commercial Bank, Campbell, 310; Strange *v.* Houston & T. Ry. Co. 53 Tex. 162; Salisbury Mills *v.* Townsend, 109 Mass. 115; Pratt *v.* Mechanics' Nat. Bank, 123 Mass. 110; Bank *v.* Lanier, 11 Wall. 369; in re Bahia etc. Ry. Co. L. R. 3 Q. B. 584; Hart *v.* Frontino etc. Co. L. R. 5 Ex. 111; Simm *v.* Anglo-American Tel. Co. L. R. 5 Q. B. D. 188.

[4] Machinists' Nat. Bank *v.* Field, 126 Mass. 345.

The rules of equitable estoppel relative to forgery in stock certificates were applied in a case where a loan was made by a bank in good faith upon a memorandum of indebtedness, as collateral security for which there was pledged what purported to be a certificate for two hundred shares of stock of a railway company issued in the name of the bank. The certificate in fact was originally for two shares only, and in the name of a third person, the alterations being made by forged erasures and interlineations. Upon payment, the cashier of the bank, there being no suspicion of the genuineness of the certificate, indorsed the same in blank, to restore its availability to the pledgor, and returned it to him. Afterwards another loan was obtained from Matthews upon the same collateral. The forgery being discovered, and the pledgor arrested and bankrupt, Matthews brought an action against the bank upon the cashier's indorsement. The rules of estoppel in pais were enforced against the bank to set up the forgery as a defense to the claim of the second pledgee, "because it would be a wrong on its part and injury to others whose conduct had been influenced by its acts and omissions."[1] The same rules of estoppel were applied in favor of a holder for value, in good faith, of a certificate of stock, where such certificate, while in the name of a third person, was in possession of the owner, but was stolen from him by such third person, and negotiated as by one having the legal title.[2]

§ 311. The Title acquired under fraudulent issues of Fictitious Stock.—The title of pledgees of certificates of stock, holding the same for value advanced in good faith, without notice of defenses, is sustained where the issue and hypothecation of such stock is a fraud on the part of the officers of the company issuing the same. The rule is limited to cases where such issue of fictitious

[1] Matthews *v.* National Bank, Holmes, 396.

[2] Winter *v.* Belmont Mining Co. 53 Cal. 428

stock is made by the governing officers of a corporation and the recognized representatives of it, with plain authority to make transfers and issue certificates. In such cases (as said by the United States Supreme Court, in the case of Pollard *v.* Vinton),[1] "*The officer is the corporation* [the italics are those of the court] for many purposes. Certainly a corporation can be charged with no intelligent action, or with intending any purpose, or committing any fraud, except as this intelligence, this purpose, this fraud, is evidenced by the actions of its officers. And while it may be conceded for many purposes they are agents, and are to be treated as agents of the corporation, or of the corporators, it is also true that, for some purposes, they are the corporation, and their acts as such officers are the acts of the corporation itself." The court (by Miller, Jus.) cite in this connection the case of the N. Y & N. H. R. R. Co. *v.* Schuyler.[2] The Schuyler frauds in connection with the capital stock of the New York and New Haven Railroad Company gave occasion to the leading cases on the subject of the rights of holders of certificates of stock, for value, without notice, where the transactions were grossly fraudulent, and the issue of fictitious stock enormous. The railroad company, however, received the benefit of part of the money raised upon the fictitious stock as collateral security, using it in the construction of the road. Schuyler himself was president and director, as well as transfer agent.[3]

§ 312. ESTOPPEL IN PAIS AS APPLIED AGAINST CORPORATIONS.—The principles upon which such decisions are founded are stated in New York and New Haven Railroad Company *v.* Schuyler. The natural and established distinction between that which a corporation is not authorized to do under any circumstances, or which in its very nature

[1] 105 U. S. 712.
[2] 34 N. Y. 30.
[3] N. Y. & N.H. R.R. Co. *v.* Schuyler, 34 N. Y. 30; Bridgeport Bank *v.* N.Y. & N.H. R.R. Co. 30 Conn. 231.

is utterly prohibited by law, or its charter, and that which it may do for certain purposes, and not for others, or on the happening of a particular event, is recognized in the opinion.[1] The rule is then applied to corporations and their officers that where a principal has clothed his agent with power to do an act upon some extrinsic fact, necessarily and peculiarly within the knowledge of the agent, and of the existence of which the act of executing the power is itself a representation, a third person dealing with such agent in entire good faith, pursuant to the apparent power, may rely upon the representation, and the principal is estopped from denying its truth to his prejudice.[2] Corporations are held responsible to the same extent, and under the same circumstances, that a natural person is chargeable with the acts or neglects of his agent; and if the agents employed conduct themselves fraudulently so that if they had been acting for private employers the persons for whom they were acting would have been affected by their fraud, the same principle prevails where the principal under whom the agent acts is a corporation.[3] And a civil action may be brought against such corporation by an injured person for every grade and description of forcible, malicious, or negligent tort or wrong which it commits, however foreign to its nature or beyond its powers by law or charter the wrongful transaction may be.[4] But

[1] Mechanics' Bank *v.* Bank, 16 N. Y. 151, 155; N.Y. & N.H. R.R. Co. *v.* Schuyler, 34 N. Y. 30; Willis *v.* Philadelphia and Darby Ry. Co. 13 Phila. 33.

[2] Railroad Co. *v.* Schuyler, 34 N. Y. 30; Griswold *v.* Haven, 25 N. Y. 595.

[3] Railroad Co. *v.* Schuyler, 34 N. Y. 30; Merchants' Bank *v.* State Bank, 10 Wall. 650; Thayer *v.* Barlow, 19 Pick. 511; Frankfort Bank *v.* Johnson, 24 Me. 490; Ranger *v.* Great Western Ry. Co. 5 H. L. Cas. 86.

[4] Railroad Co. *v.* Schuyler, 34 N. Y. 30; Bissell *v.* Railroad Co. 22 N. Y. 305, 309; Goodspeed *v.* Bank, 22 Conn. 54; Life Insurance Co. *v.* Insurance Co. 7 Wend. 31; South & N. Ala. R. R. Co. *v.* Chappell, 61 Ala. 529; Albert *v.* Savings Bank, 2 Md. Dec. 169; Carter *v.* Howe Machine Co. 51 Md. 290; Williams *v.* Ins. Co. 57 Miss. 759; Frankfort Bank *v.* Johnson, 24 Me. 490; Beach *v.* Ful-

in order to be entitled to the application of the rules of estoppel the person relying upon the false representations of another must have been ignorant of the truth, and have acted upon such false representations.[1]

§ 313. Equitable Estoppel, as enforced in National Bank *v.* Watsontown Bank.—The rules of equitable estoppel, or estoppel by conduct, were applied by the United States Supreme Court, in the late case of National Bank *v.* Watsontown Bank,[2] arising out of a claim to a transfer and issue of certificates by the latter bank under a pledge of its shares to the Cecil National Bank by Powell & Co., with power of sale upon default. Such default occurring, the certificates were forwarded to the bank for transfer, and entries were made in the ledger. Upon request of the pledgee, the cashier of the Watsontown Bank undertook to sell the stock and sold some shares, making debit and credit entries on the stock ledger. The pledgor became insolvent, and the bank then refused to complete the transfer, claiming a statutory lien upon the stock for an indebtedness of the

ton Bank, 7 Cow. 436; Ricord *v.* Central Pac. R.R. Co. 15 Nev. 167; Alexander *v.* Relfe. 74 Mo. 495; Boogher *v.* Life Assn. 75 Mo. 325; Philadelphia Ry. Co. *v.* Quigley, 21 How. (U. S.) 209; National Bank *v.* Graham, 100 U. S. 702; Copley *v.* Machine Co. 2 Woods, 494; Chesnut Hill Turnpike Co. *v.* Rutter, 4 Serg. & R. 16; Fenton *v.* Machine Co. 9 Phila. 189; Cumberland Ry. Co. *v.* Baab, 9 Watts, 458; Vance *v.* Erie Ry. Co. 32 N. J. L. 334; Green *v.* London Omnibus Co. 7 C. B. N. S. 290; National Ex. Co. *v.* Drew, 2 McQ. H. L. Cas 103; Yarborough *v.* Bank of England, 16 East. 6; Walker *v.* Railway Co. L. R. 5 C. P. 640.

[1] Wright's App. 99 Pa. St. 425. The facts were: A, the president of a company, induced B, by false representations that the company needed the aid of her stocks, to surrender her certificates, indorsed with blank power of attorney, A giving to B his own due-bill. The stock was then transferred and sold to an innocent holder for value, the proceeds being appropriated by B. Subsequently, by connivance with other officers, A obtained the issue of shares in excess of the charter limit to B, the company continuing to pay dividends to her. A bill was brought to hold the company liable on the fictitious stock, but was dismissed upon the limitation of the doctrine of estoppel stated in the text.

[2] National Bank *v.* Watsontown Bank, 105 U. S. 220.

pledgor. The court (Matthews, Jus.) say: "On the supposition that not the legal title, but only an equity, based upon an executory contract for a transfer, passed to the appellants, by virtue of the transaction with the cashier of the Watsontown Bank, their right to the relief prayed for is not less clear. Aside from the recognition of the title, as complete, by accepting and acting upon the power of attorney given by Tome to sell and transfer it as his stock, and the sales made to the Scotts under it, whose title is not denied, and yet cannot be better than that of their vendor, which is disputed, the subsequent conduct of the Watsontown Bank raises an equity against it, which is superior to its legal right to insist upon a lien on account of the debt of Powell & Co. [the pledgors]. When Tome made his claim on behalf of the Cecil National Bank [the pledgee] for a transfer of the stock, if the appellee had intended to insist on its legal rights and assert its lien, then was the proper time to do it; for it then, at least, had notice of the interest and the claim of the appellants. If it had done so promptly the latter might still have had an opportunity to obtain other security, or to enforce by other means their claims against their debtors, who, although in default, do not appear to have been as yet *in extremis*. So far, however, from adopting this course, the Watsontown Bank pursued one exactly the reverse. It permitted the parties by its actual exercise to rest in the belief that their right to dispose of the stock for the purpose of paying the debt due them would not be questioned, until the failure and assignment of Powell & Co. made any other resort useless; and, having induced them to alter their condition by reliance upon assurances, which were equivalent to a declaration that it had no adverse claim, the appellee cannot now be permitted to assert a lien, lost by its own laches, and the enforcement of which would operate as a fraud."

§ 314. EQUITABLE ESTOPPEL AS APPLIED TO THE TERMS OF CERTIFICATES.—The rules of equitable estoppel as ap-

plied to representations made by a company upon the face of certificates of stock by which a company is estopped to deny that it has the stock represented by the certificates are enforced where it is stated that the shares of stock are transferable upon the books of the company only upon the return and cancellation of the certificate. A by-law upon its records that such certificates of stock may be transferred by a separate instrument does not affect the application of the rule of estoppel. The fact that other shares of stock have been issued by the company upon an assignment by an independent deed, or upon other considerations, without the surrender of a certificate, so worded, is no excuse or defense for the company, as against a holder of the certificate, indorsed for value advanced in good faith, without notice of equities.[1] The holder for value of a certificate issued by the proper officers of a corporation, without notice of fraud, or other defenses against the same, has a primary and direct claim, either to be admitted as a stockholder of the corporation, or where that is impossible, the limit placed by the charter upon the issue of stock having been reached, to such damages as shall be sufficient to recoup him for his loss.[2] Such holder for value, without notice, upon a transfer of the shares of stock to his name upon the books of the company, is protected, although there be no authority on the part of the company to make the transfer because of the number of shares of stock already issued.[3] Although a certificate of stock itself is not the title to the shares of stock, it is an authoritative declaration that such a title exists, which may operate as an equitable estoppel in favor of third persons who part with value in the belief that it is true.[4]

[1] Strange *v.* Houston & T. Ry. Co. 53 Tex. 162; Holbrook *v.* N. J. Zinc Co. 57 N. Y. 616; McNeil *v.* Tenth Nat. Bank, 46 Ib. 331; N. Y. & N. H. R. R. Co. *v.* Schuyler, 34 Ib. 81; Brisbane *v.* Railroad Co. 25 Hun, 438; Bayard *v.* Bank, 52 Pa. St. 235.

[2] Bank of Kentucky *v.* Schuylkill Bank, 1 Pars. 180.

[3] Bayard *v.* Bank, 52 Pa. St. 232.

[4] Bank of Kentucky *v.* Schuylkill Bank, 1 Pars. 180; Railroad Co. *v.* Schuyler, 34 N. Y. 30, 52, 80; in re Bahia & S. F. Ry. Co. L. R. 3 Q. B.

§ 315. Estoppel of real Owner by blank indorsement of Certificates.—The real owner of shares of stock holding the certificates may estop himself as against any claim against a company to replace his stock, or to pay him damages for an unauthorized transfer thereof, by gross carelessness in his acts in and about such certificates, or by his indorsement in blank and delivery of them. The real owner may estop himself, by making a blank indorsement, with irrevocable power of attorney to transfer, upon his certificate of stock, and then entrusting the same to a third person, under a secret restriction as to the use to be made of it, not appearing upon the certificate, and known only to the parties. By such indorsement and delivery of the certificates, the legal title and apparent ownership vest in the holder. Where such certificates pass into the hands of bona fide pledgees, for value, without notice, the real owner, whose misplaced confidence has enabled the deception to be practised, must suffer the loss. In dealings with his certificates, the owner is required to use reasonable care, as when indorsed in blank and in the hands of a third person, the presumption is that he is a holder for value, entitled to use

595. In Willis *v.* Philadelphia & Darby Ry. Co. 13 Phila 33, the court (Hare, P. J.) say: "It is well settled that one who, as a purchaser or lender, gives value on the faith of a certificate of stock, authenticated by the seal of the corporation and the signatures of the proper officers, acquires an equitable title and may require the corporation to transfer the stock to him, or respond in damages for the default. It is not a sufficient answer to such a demand that the certificate was fraudulently issued, because corporations are not less than natural persons answerable for the conduct of their agents in the business entrusted to their care. Nor is it necessarily conclusive against such a purchaser that the party from whom he bought was cognizant of or participated in the fraud. If a certificate of stock is not a negotiable instrument, it is a written declaration that the holder has a definite share in the capital or profits of the concern, which, though delivered to him, is intended for circulation and virtually addressed to all the world, and third persons who are misled by such an instrument, may justly require that the loss shall fall on the corporation, and not on them."

such certificates of stock as he pleases.[1] Where, however, reasonable care has been exercised by the owner, he is not responsible for the loss. As where blanks in a power of attorney indorsed on a certificate for 200 shares were filled, so as to transfer 50 shares only, but by unauthorized changes and erasures the indorsement was made to cover the whole 200 shares. The officers of the company with great negligence, issued a new certificate upon the surrender of the erased and forged certificate, without inquiry. The company was required either to replace the stock, or to pay the owner the market value at the time of entering the decree.[2]

A bona fide holder for value, without notice, of a certificate of stock, with a warrant of attorney to transfer indorsed in blank by the treasurer of a company negotiating the same, is protected as against persons subsequently purchasing the same stock at a general sale of the assets of such company, who received no certificate. Having a right to presume the act of indorsement was made by the officer whose functions naturally and reasonably included such an act and that it was preceded by all needful circumstances, the holder was not required to seek a verification of the presumption by an inspection of the corporation books. Third persons are authorized to act upon the indorsement by such an officer as being an authentic proceeding of the corporation, although it be, in fact, a fraud.[3] Where trustees of a corporation, having charge of the transfer of shares, permitted certain shares to be transferred to an innocent person, advancing value, without notice, by one acting in fraud and without authority, the loss resulting was placed upon the stockholders, in a suit between the latter and the innocent person.[4]

[1] Wright's App. 99 Pa. St. 425; Pennsylvania R. R. Co.'s App. 86 Ib. 80; Borland *v.* Clark, 26 Kans. 349; Ault *v.* Colket, 2 W. N. C. 322; Coles *v.* Bank of England, 10 A. & E. 437; Young *v.* Grote, 4 Bing. 252.

[2] Sewall *v.* Boston Water Power Co. 4 Allen, 277.

[3] Walker *v.* Detroit Transfer Co. 47 Mich. 338.

[4] Cohen *v.* Gwynne, 2 Md. Ch. Dec. 357.

§ 316. The misappropriation of Stock certificates by Brokers and Agents.—The owner of shares of stock in a corporation, holding the certificates issued therefor, who, having indorsed such certificates with an irrevocable power of attorney to transfer it in blank, entrusts the same, in the usual courses of business, to a third person as a broker or agent, for some special purpose, is estopped to set up any fraud or misappropriation on the part of such broker or agent, as against an innocent pledgee, advancing value, without notice, upon the apparent ownership of the certificates by such a broker or agent. No secret equities of fraud or misappropriation can be set up by such owner, as existing between the agent or broker and himself, to the prejudice and loss of a pledgee for value, without notice. The person, who thus places another in a position so that he is able to commit a fraud, should suffer the loss rather than an innocent pledgee, who deals with such person upon the credit of his possession of such indicia of title as a certificate of stock indorsed in blank and apparent ownership thus conferred.[1] Upon a pledge of stock certificates by an agent or other person entrusted with the legal title thereto by indorsement in blank and apparent ownership, for his own debt, as against a pledgee, advancing value, in good faith, in the usual course of business, and without notice of the secret equities between the real owner and the pledgor, or that any person claimed an interest therein other than the pledgor, the owner is estopped to set up such fraud and misappropriation to defeat the title thus acquired.[2] Certificates of stock held in secret trust by A, with full evidences of title, were transferred to B, and B in turn, transferred to C, both trans-

[1] Burton *v.* Peterson, 12 Phila. 397; Burton's App. 93 Pa. St. 114; Penn. R. R. Co.'s App. 86 Ib. 80; Dovey's App. 97 Ib. 53; Borland *v.* Clark, 26 Kan. 349; Saltus *v.* Everett, 20 Wend. 278; Crocker *v.* Crocker, 31 N. Y. 507; McNeil *v.* Tenth Nat. Bank, 46 Ib. 325; Weaver *v.* Barden, 49 N.Y. 286; Atlantic Bank *v.* Ferree, 17 N. J. Eq. 117; Stone *v.* Maryx, 14 Nev. 362; Strange *v.* Houston & T. R. R. Co. 53 Tex. 162; Thompson *v.* Tolland, 48 Cal. 112; Gass *v.* Hampton, 16 Nev. 185.

[2] Otis *v.* Gardner, 105 Ill. 436.

fers being for value, and without notice, actual or implied, either by B or C, that a secret trust existed in favor of third persons. The cestuis que trust are estopped to object to the transfers.[1]

The rules of equitable estoppel were applied in favor of stock brokers, who, upon request, and delivery of certificates of stocks, duly indorsed, by one claiming to own them, but who, in fact, held them as collateral security for a debt, the amount of which had been tendered by the real owner of the stock, but refused, sold the shares on the stock exchange, paying the proceeds to the person from whom they received them, without any knowledge of the previous transactions. The real owner sued the stock brokers to recover damages. The action of the stock brokers in making such sale, not depending upon the actual title or authority of the party with whom they dealt directly, but having been derived from the acts of the real owner, the latter was estopped from disputing as against them, the existence of the title or power, which through neglect or mistaken confidence was caused or allowed to appear to be vested in the person who delivered the certificates to them.[2] But where blank transfers of shares had been delivered to a broker for a valid purpose, and in order to carry out a deceit and fraud and to secure the money of innocent persons, the broker was obliged to resort to felony to get the certificates, and to forgery to render them available, the principle was announced in an action against the company, by the defrauded owner to have his shares replaced, that, in order to constitute an estoppel *in pais* as against him, his negligence must have been the proximate cause of the deceit, and that the principles of equitable estoppel required not only an act invalid *per se*, but a person forbidden to assert its invalidity, for equitable reasons.[3]

[1] Borland *v.* Clark, 26 Kan. 349.
[2] Stone *v.* Maryx, 14 Nev. 362.
[3] Swan *v.* N. B. Aust. Co. 7 C. B. N. S. 400; s. c. 7 H. & N. 603; (Wilde, B.); aff. 2 H. & C. 175.

§ 317. Essential conditions of Pledge, under misappropriation and fraud.—Absence of knowledge or notice of misappropriation is essential where certificates of stock are received as collateral security from persons entrusted with the legal title and apparent ownership, in order to entitle the pledgee to protection. Bad faith, or knowledge or notice of fraud is necessary to defeat the pledgee's title, who advances money upon such evidences of title and ownership; but where these are shown, no title can be acquired even by a holder for value.[1] A certificate of stock was appropriated by an agent entrusted therewith, to its proper purpose as collateral security, the name of the pledgee being inserted in the power of attorney, and the debt having been paid, the stock was returned to the agent. A pledgee subsequently receiving the same, being chargeable with notice of the erasure of the name of the first pledgee, acquired no rights therein as against the real owner, the limited authority of the agent expiring with the making of the first pledge.[2] The pledgee in cases of misappropriation of stock certificates, must also be a holder for value in good faith, without notice, in the usual course of business. So far as the same are pledged as collateral security for an antecedent debt, without further consideration, the title of the pledgee is subject to antecedent equities in states where the restricted rule prevails.[3]

A pledge of a certificate of stock of a bank was made by a cashier as collateral security for an advance to himself, the certificate being one of several signed in blank by the president, and was also signed by the cashier, and filled up with the name of the latter as owner. Although the pledgee advanced money in good faith and was in a general sense an innocent holder of the certificate, the circumstances that the cashier was acting for himself in issuing the cer-

[1] Crocker *v.* Crocker, 31 N. Y. 507; Porter *v.* Parks, 49 Ib. 564; Strange *v.* Houston & T. R. R. Co. 53 Tex. 162.

[2] Denny *v.* Lyon, 38 Pa. St. 98.

[3] Weaver *v.* Barden, 49 N. Y. 286; Strange *v.* Houston & T. R. R. Co., 53 Tex. 162.

tificate, and was using it for his own benefit, charged the pledgee with the duty of inquiry; and failing to make the investigation, which, if made, would have developed the fraud, she was not an "innocent person," the issue of the certificate being unauthorized and a fraud, nor was the pledgee entitled to an action for her loss as against the bank.[1]

§ 318. Measure of damages, in cases of Forgery and Spurious Stock.—The measure of damages allowed the real owner, where a company has issued upon forged indorsements new certificates of stock which have passed into the hands of innocent holders for value, without notice, is the value of the stock at the time of the demand for the issue of new shares, with any dividends that may have accrued; or the company may be required to replace the stock, issue new certificates, and pay dividends.[2] As against a prior indorser of a certificate, erased and forged, but without knowledge thereof, upon the faith of whose indorsement advances were made upon the certificate as collateral security, the pledgee recovered the whole amount of his loan, the pledgor having become bankrupt, and a felon by reason of the forgery.[3] In a case where a company refused to transfer stock, new certificates having been already issued upon fraudulent misrepresentations, damages were estimated at the market value of the stock on the day of demand, and interest.[4] The like rule was applied in a case of certificates tainted with forgery, the question of damages, if there were no market value at the time of the demand, being left with the jury on the evidence.[5] Where erasures had been made upon a certificate increasing the number of shares intended to be transferred, and other forgeries, the company was

[1] Moores *v.* Bank, 15 Fed. Rep. 141; aff. 111 U. S. 156; *see* Western R. R. Co. *v.* Bank, 60 Md., 36.

[2] Telegraph Co. *v.* Davenport, 97 U. S. 369; Pollock *v.* National Bank, 7 N. Y. 274.

[3] Matthews *v.* Bank, Holmes, 396.

[4] Willis *v.* R'y Co. 13 Phila. 33; Woodhouse *v.* Ins. Co. 35 La. Ann. 238.

[5] In re Bahia & S. F. Ry. Co., L. R. 3 Q. B. 594; Swan *v.* Mining Co. 13 Q. B. D. 105.

required either to replace such extra shares, or to pay the owner the market value at the time of entering the decree.[1]

The measure of damages allowed in equity to pledgees, holding spurious certificates of stock as collateral security for notes of the pledgor, the president of a railroad company issuing the stock, and who had loaned their money on the credit of the representations contained in such certificates, the pledgees receiving them, indorsed with the usual powers to transfer, in blank, is subject to the rule that such stock is held liable to any loss or deterioration in its value which might possibly result from the fraudulent or negligent conduct of officers or directors. The pledgees of the stock were not creditors, nor could the entire property of the company be devoted to their payment to the exclusion of other persons whose equity was equal to their own. As no demand for a transfer of the stock had been made, the rule of damages applied was, that, while the pledgees holding genuine certificates should be given other valid certificates of stock, those who had advanced their money upon the spurious certificates, issued beyond the limit prescribed by the charter, should be paid by the company a sum equal to the value of the shares claimed by them upon the hearing before the master to assess damages.[2] In the case of the Bank of Kentucky *v.* Schuylkill Bank,[3] the Legislature of Kentucky, upon request, passed a law authorizing the corporation in that case to issue an amount of valid stock equal to and to be used in place of that issued fraudulently.

[1] Sewall *v.* Boston Water Power Co., 4 Allen, 277.

[2] Willis *v.* Philadelphia & Darby Ry Co., 13 Phila. 33.

[3] 1 Pars. Eq. 180.

CHAPTER XXXII.

THE SUB-PLEDGE OF STOCK CERTIFICATES.

§319. The transfer and sub-pledge of stock certificates.
320. Sub-pledges of stocks for loans greater than principal debt.
321. The sub-pledge of stock certificates indorsed in blank.
322. Sub-pledges of stock certificates.
323. The Massachusetts rule as to sub-pledges of stock certificates.
324. Sub-pledges upon void loans and antecedent debts, when subject to equities.
325. Sub-pledges under a limited title.
326. Equitable application by sub-pledgee of proceeds from securities.
327. The broker's use of customer's stock certificates.

§ 319. THE TRANSFER OF STOCK CERTIFICATES BY PLEDGEE.—The pledgee holding certificates of stock, indorsed by the owner in blank, with irrevocable power of attorney to transfer, upon a present loan or discount of commercial paper, may make his collateral securities available for the purpose of raising money thereon. He may assign and transfer absolutely his interest in such collaterals, together with the personal obligations of the pledgor. The pledgee may also sub-pledge the collateral stock securities held by him, having the legal title, upon a bona fide advance or discount by a third person, not exceeding in amount the indebtedness for which such certificates of stock are held as collateral. The pledgor will have no cause for complaint by either of these valid uses of collateral securities. He may entitle himself to a return of such securities upon payment of the amount of his original debt at maturity, to such assignee or sub-pledgee holding the same. The right to transfer and to sub-pledge such collateral securities is a right which every lender of money

has. Without it, the business of banks and brokers could not be carried on, and commerce itself would be needlessly restricted.[1]

§ 320. Sub-pledges of Stocks for loans greater than principal Debt.—The pledgee of stock certificates, indorsed in blank, holding the legal title and apparent ownership, may confer upon a sub-pledgee advancing value upon the credit of such title and apparent ownership, in good faith, and without notice of equities, a more extended right, as against the owner and pledgor, than he himself has. The presumption arises in favor of third persons advancing money in good faith and without notice that one in possession of certificates of stock indorsed in blank is the owner thereof, a holder for value, with a good title. The act of sub-pledge, by a pledgee holding the title and possession, for a loan greater in amount than the principal debt, is unauthorized and fraudulent as between the parties to the original contract of pledge; but as against the innocent sub-pledgee for value, without notice, the owner is estopped to set up any defenses or equities. Having enabled the fraud and deceit to be practised, by his misplaced confidence in allowing the pledgee to appear as the owner of certificates of stock, indorsed in blank, the pledgor must bear the loss.[2]

[1] Canfield *v.* Minneapolis Assn. 14 Fed. Rep. 801; Jarvis *v.* Rogers, 13 Mass. 389, 417; Goss *v.* Emerson, 23 N. H. 38; Chamberlain *v.* Greenleaf, 4 Abb. N. C. 178; Langton *v.* Waite, L. R. 6 Eq. 165; Ex parte Sergeant, 17 Ib. 279; Donald *v.* Suckling, L. R. 1 Q. B. 385, 611; France *v.* Clark, 22 Ch. D. 830; aff. 26 Ib. 257.

[2] McNeil *v.* Tenth Nat. Bank, 46 N. Y. 325; Ogden *v.* Lathrop, 65 Ib. 158; Driscoll *v.* West Bradley Manf. Co. 59 Ib. 96; Merchants' Bank *v.* Livingston, 74 Ib. 223; Holbrook *v.* New Jersey Zinc Co. 57 Ib. 616; Crocker *v.* Crocker, 31 Ib. 507; Kortright *v.* Commercial Bank, 20 Wend. 91, s. c. 22 Ib. 348; Chamberlain *v.* Greenleaf, 4 Abb. N. C. 178; Felt *v.* Heye, 23 How. Pr. 359; Fatman, *v.* Lobach, 1 Duer. 354 · Leavitt *v.* Fisher, 4 Ib. 1; Prall *v.* Tilt, 28 N. J. Eq. 493; Mt. Holly Turnpike Co. *v.* Ferree, 18 Ib. 17; Wood *v.* Smith, 92 Pa. St. 379; Penn. R. R. Co.'s App. 86 Ib 83; Bank of Kentucky *v.* Schuylkill Bank, 1 Pars. Eq. 248; Cherry *v.* Frost, 7 Lea, 1; Jarvis

In the leading case of McNeil *v.* Tenth National Bank[1] (Rapallo, J.), involving the claims of a pledgor as against a sub-pledgee of stock certificates, indorsed in blank, the acknowledged rule of equitable estoppel was declared, that "where the true owner holds out another, or allows him to appear as the owner of or as having full power of disposition over the property, and innocent third parties are thus led into dealing with such apparent owner, they will be protected. Their rights in such case do not depend upon the actual title or authority of the party with whom they deal directly, but are derived from the act of the real owner, which precludes him from disputing, as against them, the existence of the title or power, which through neglect or mistaken confidence, he caused or allowed to appear to be vested in the party making the conveyance." The court further say: "If the owner entrusts to another not merely the possession of the property, but also written evidence over his own signature of title thereto,

v. Rogers, 13 Mass. 105; s. c. 15 Ib. 389; Gass *v.* Hampton, 16 Nev. 185; Stone *v.* Maryx, 14 Ib. 362; Brewster *v.* Sime, 42 Cal. 139; Thompson *v.* Tolland, 48 Ib. 112; Mocatta *v.* Bell, 27 L. J. Ch. 237; in re Tahiti Cotton Co. L. R. 17 Eq. 273; Langton *v.* Waite, 6 Ib. 165; Simm *v.* Anglo-Am. Ry Co. 5 Q. B. D. 188.

[1] 46 N. Y. 325, 329, 330. McNiel was the owner of shares of stock of a national bank, the certificate of which he delivered to and left with his stockbroker as collateral security for any balance of account. Upon the certificate was indorsed an assignment in blank, as follows:

"For value received, the undersigned hereby assigns and transfers unto * * * shares of the capital stock of the First National Bank of St. Johnsville, and do hereby constitute and appoint * * * true and lawful attorney, irrevocably for * * and in * * name and behalf, to make and execute all necessary acts of assignment and transfer required by the regulations and by-laws of said bank.

"In witness whereof, I have hereunto set my hand and seal this * day of

"(Signed) B. McNeil.

"Sealed and sworn in presence of * * * "

Without authority, and without the pledgor's knowledge, the brokers pledged the stock with other collateral to another broker as security for a loan of $45,000. At the request of the broker, the defendant bank paid the loan of $45,000 and received the collateral securities. The broker became insolvent and the original pledgor demanded the

and an unconditional power of disposition over it, the case is vastly different [from that of the pledgee of an ordinary chattel]. There can be no occasion for the delivery of such documents, unless it is intended that they shall be used, either at the pleasure of the depositary, or under contingencies to arise. If the conditions upon which this apparent right of control is to be exercised are not expressed on the face of the instrument, but remain in confidence between the owner and the depositary, the case cannot be distinguished in principle from that of an agent who receives secret instructions qualifying or restricting an apparently absolute power. * * * I am at a loss to perceive on what principle it can be claimed that an apparent naked authority is more effectual to bind the party giving it than an apparent ownership as well as authority."

§ 321. THE SUB-PLEDGE OF STOCK CERTIFICATES INDORSED IN BLANK.—The usage of indorsing certificates of stock in blank renders them, although not negotiable like the favored instruments of commerce, but so far quasi-negotiable that, under the application of the rules of equitable estoppel, they pass from hand to hand in bona fide transactions of loan free from antecedent equities. An irrevocable power of attorney executed in blank by the owner in whose name the certificate of stock is issued, enures to the benefit and advantage not only of the first holder of such certificate for value, in good faith, without notice, to whom it may be delivered, but as in the case of commercial paper indorsed in blank or payable to bearer, every subsequent holder for value is entitled to the privileges resulting

return of the stock from the bank, upon payment of the amount due upon his account, about $3,000, the bank's interest in the stock, after deducting the amount realized from the other collaterals, being over $15,000. The shares were worth $17,000. The account, however, had not been rendered nor demand made. The lower court decided in favor of the pledgor, and the case was twice argued in the Court of Appeals, the decision supporting the rights of the bank acquired under the sub-pledge, and without knowledge of the pledgor's title to the stock.

therefrom. Where such certificates of stock, indorsed in blank, are in the possession of a pledgee, who sub-pledges the same, no notice or knowledge sufficient to put such sub-pledgee upon inquiry is presumed from the fact that the certificate is in the name of another person, otherwise the availability of stock certificates as collateral would be in great part destroyed.[1]

A indorses in blank and delivers to B certificates of stock as collateral, upon which he obtains a loan. B. sub-pledges the certificates to C for value, who again sub-pledges them to D, the indorsement remaining blank. The last pledgee D, if a holder for value, in the usual course of business, has a good title against everybody.[2]

§ 322. Sub-pledges of Stock certificates.—The sub-pledge of stock certificates held by pledgees with title is supported where made upon an advance, or other valuable consideration, in good faith, without notice, although the pledgee may be chargeable with notice of misappropriation. A pledge of stocks belonging to an estate was made by one of several executors to stockbrokers as collateral security for his own indebtedness upon stock speculations, with power of attorney signed "A., acting executor." The brokers, who were chargeable with notice of the misappropriation, sub-pledged the stock for a loan made in good faith, without notice. The fraud being discovered, the remaining executors sought in equity to recover the stocks from the sub-pledgees. They were only given relief upon the equitable terms of paying the full advances of the sub-pledgee.[3]

The technical doctrine of lis pendens is not enforced to defeat the title of a sub-pledgee of certificates of stock for

[1] Wood's App. 92 Pa. St. 379; Felt *v.* Heye, 23 How. Pr. 359; Leavitt *v.* Fisher, 4 Duer. 1; Kortright *v.* Commercial Bank, 20 Wend. 91; McNeil *v.* Fourth Nat. Bank, 46 N. Y. 325 (Rapallo, J.). In re Tahiti Cotton Co. L. R. 17 Eq. 273.

[2] Gould *v.* Farmers' Loan & Trust Co., 23 Hun, 322.

[3] Wood's App. 92 Pa. St. 379.

value, without notice. Upon discovery of a previous misappropriation of stocks of an estate by an executor, a court of equity appointed a new trustee. The court was about to order the company to transfer the stocks to the trustee, but before the entry thereof, the executor indorsed the certificates in blank, and passed them to a third person for value advanced, who sub-pledged them for a loan. Upon default, the sub-pledgee sold the stocks, but the company gave public notice that there were no such stocks, and the pledgee had to buy them himself. The company still refusing to transfer, the sub-pledgee recovered the full amount of his damages.[1]

Stocks pledged upon a loan of money were sub-pledged for value, and on the same day were again sub-pledged with other collaterals for a loan and as collateral security for an antecedent debt, without more. The second sub-pledgee, so far as he had made a bona fide advance, was protected as a holder for value in the usual course of business; as to the past indebtedness, the transaction occurring in New York, he was subject to equities. The first pledgee paid the full value of the stock to redeem it, and was allowed to recoup himself from the sale of the other collaterals, after the second sub-pledgee had repaid himself his actual advances, upon which he was a holder for value of the securities.[2]

It is no defense to a customer as against a suit brought for the price of stocks bought by a broker that, under the well-established usage of stockbrokers to use stocks which they are carrying as collateral to raise money to continue their business, that a sub-pledgee of such stocks, upon default, had sold the stocks. The failure of the broker to redeem being a default in a subsequent duty, the liability of the customer continued. The latter, however, might recoup his damages.[3]

[1] Holbrook *v.* New Jersey Zinc Co. 57 N. Y. 616.

[2] Gould *v.* Farmer's L. & T. Co. 23 Hun, 322; Stenton *v.* Jerome, 54 N. Y. 480.

[3] Capron *v.* Smith, 86 N. Y. 418; Gruman *v.* Smith, 82 Ib. 25.

As no notice is charged from the use of the words "as trustee" in mining stocks, and no presumption as to the existence of any cestui que trust arises therefrom, a pledgee holding such stocks as collateral for stock speculations, may sub-pledgee the same for a loan and future advances. Where this is done, the pledgor and owner is bound to the pledgee for the full amount of the loan and advances until notice of the pledgor's interest.[1]

§ 323. The Massachusetts rule as to Sub-pledges of Stock certificates.—In Massachusetts, the rule is established that a pledgee of stock holding certificates of stock under written assignment and blank power of attorney indorsed thereon may cause a transfer to be made upon the books of the company either to himself, or to some other person as trustee, so as to protect the title and possession to the collaterals. Such a right on the part of the pledgee is necessarily implied.[2] The pledgee, however, is not permitted, under statutory enactments, to sell or loan or pledge the stock thus held as collateral, but is required to retain the same in his possession, so that upon the maturity of the debt, or at any time afterwards before a proper sale, he may be in a position, upon payment, to restore such stock to the pledgor.[3] Certificates of stock held as collateral, under a blank power of attorney, absolute in terms, the receipt given therefor showing it to be held as collateral security for a loan, were transferred by the pledgee to his own creditor in order to fulfil a prior contract for borrowed stock. Such a transfer operated as a conversion of the stock. The pledgee, upon failure to pay the loan, sold the same number of like shares of stock and sued for the balance of the debt unsatisfied. The pledgor was allowed, in such action, to set-off the wrongful conversion, and to recover

[1] Gass *v.* Hampton, 16 Nev. 185.

[2] Day *v.* Holmes, 103 Mass. 306; Fay *v.* Gray, 124 Ib. 500.

[3] Fowle *v.* Ward, 113 Mass. 548; Fay *v.* Gray, 124 Ib. 500; Hathaway *v.* Fall River Bank, 131 Mass. 14.

the difference between the value of the stock at the time of the conversion and the amount due on the note, and had a judgment for the difference.[1] Nor is it any excuse, in Massachusetts, for a wrongful sale or pledge of such stock that the pledgee has always held a sufficient number of like shares to return to the pledgor upon payment of the debt secured.[2] But it is not a conversion of stock where a transfer of the certificates is made to third parties while held as collateral for the purpose simply of avoiding injury to the credit of the pledgee who received the certificates indorsed, and was ready to return them to the pledgor upon payment.[3]

§ 324. Sub-pledges upon void Loans and antecedent Debts, when subject to equities.—No title is conveyed, as against the pledgor, where the sub-pledgee of certificates of stock, properly indorsed, is based upon a transaction of loan between the pledgee and sub-pledgee tainted with usury and void by statute. The sub-pledgee receiving stock certificates upon such void loan is not a holder for value in the usual course of business. If any recovery can be had, as where such contracts are voidable only, the sub-pledgee is subject to prior equities.[4] A borrowed money from B on stock certificates indorsed in blank, and B sub-pledged them to C, who was without notice of A's rights, for a loan to himself, retaining the principal notes. The loan made by the sub-pledgee was tainted with usury. Upon default, the sub-pledgee sold the collaterals. The pledgor sued to recover either the stock or the proceeds thereof, and took judgment, an attempt to set-off the debt due to the pledgee not being allowed, as

[1] Fay *v.* Gray, 124 Mass. 500.

[2] Ibid.

[3] Day *v.* Holmes, 103 Mass. 306. Nor was it a conversion of the stock, where a pledgee of shares placed the same in the name of a third person, "in order that what was intended as a security might not become a burden." Heath *v.* Griswold, 18 Blatchf. 555.

[4] Leitch *v.* Wells, 48 N. Y. 592.

the negotiable securities had not been transferred with the collaterals, and *non constat* might still be in the hands of the pledgee or a third person, a holder for value, without notice.[1]

In jurisdictions where the restricted rule is followed that an indorsement and delivery of negotiable collaterals as security for the payment of an antecedent debt, without further consideration, is not sufficient to constitute the pledgee a holder for value, in the usual course of business, a sub-pledgee receiving certificates of stock, although with the legal title and apparent ownership, as collateral security for an antecedent debt merely, without any extension of time for the payment of the principal debt, or other valuable consideration, is not a holder for value, in the usual course of business, so as to come within the rules of equitable estoppel announced in the leading case of McNeil *v.* Tenth National Bank.[2] This limited rule, subjecting sub-pledgees to secret equities, was enforced in a case where a loan was obtained through an agent of a trust company, upon the discount of a note, and certain stocks, bonds and mortgages, and other securities, as collaterals. The agent afterwards sub-pledged the note and securities to a third person as collateral security for a pre-existing debt, without further consideration. As the sub-pledgee received the securities subject to equities between the pledgor and the trust company by reason of want of consideration, he was charged, in seeking to enforce the mortgage security, with the value of the stock certificates, as the mortgage was given as a further security to the stock, and having parted with the latter, its return upon payment had been rendered impossible.[3]

§ 325. Sub-pledges under a Limited title.—It is an essential element of the application of the rule of

[1] Felt *v.* Heye, 23 How. Pr. 359.

[2] Weaver *v.* Barden, 49 N. Y. 325; Gass *v.* Hampton, supra; and Gould *v.* Farmer's L. & T. Co. 23 Hun, 322.

[3] Ashton's App. 73 Pa. St. 153.

equitable estoppel, which protects an innocent sub-pledgee loaning money to a pledgee who has been entrusted with certificates of stock, indorsed by the pledgor, that the transaction of loan shall be founded upon the credit of the legal title and apparent ownership of the pledgee. If there be no pretension on the part of the pledgee of ownership of such stock certificates, and the loan is made avowedly as for a third person, the original pledgor and owner, the latter is not within the rule of estoppel in pais stated, nor can the sub-pledgee enforce his stock collateral as against the owner, for any sum in excess of the principal debt for the payment of which the stock was first pledged. Under the circumstances stated, the sub-pledgee is chargeable with notice that the power of the pledgee may be limited, and his advances to an amount greater than the principal debt are made at his peril. This rule was enforced where a broker loaned $3,000 on a certificate of stock, which he received unindorsed. Upon applying himself for a loan upon the stock, he found it was necessary, to make his collateral available, that the certificate should be indorsed. A loan applied for by the broker as for a customer, was refused him until this was done. The pledgor was induced to indorse the certificate by the representation of the pledgee that he needed it for his own security. Upon the certificate thus indorsed, the sub-pledgee made a loan of $8,000, ostensibly for a customer of the pledgee, as stated. The sub-pledgee sought, upon default, to foreclose his lien upon the stock, but as against the pledgor, he was restricted to a recovery of the amount of the first loan.[1] A sub-pledgee can take no better title to the stock itself as represented by the certificates than the

[1] Merchant's Bank *v.* Livingston, 74 N. Y. 223. The court, however, recognize the general rule as to the more extended right which may be acquired over such collateral securities, where they are received by a sub pledgee, for value, without notice, from a pledgee holding them under indorsement in blank, with the legal title and apparent ownership, and claiming to be the owner.

owner had at the time of the sub-pledge. Where at such time of sub-pledge, the pledgor has only paid forty per cent. of the face of the stock, a sub-pledgee is a purchaser for value in the due course of business to the extent only of its then value. Nor will a subsequent payment on and change of the form of stock increase the sub-pledgee's interest therein.[1]

§ 326.—Application by sub-Pledgee of proceeds from Collaterals.—The sub-pledgee of certificates of stock is subject to equitable rules as to the application of proceeds from collateral securities, in cases where he holds certificates of stock owned by different pledgors, and theretofore received as collateral security by the several pledgees. The pledgors of such stock may require, in equity, that such securities shall be applied by the sub-pledgee *pari passu* in payment of the loan. Such sub-pledgee is not allowed to favor the collateral stocks of one pledgor at the expense of others, by an intentional discrimination in the sale thereof. Where this has been done, the equitable principle of subrogation is resorted to, although the sub-pledgee has acted without notice of the claims of the several pledgors. If by the sale of the collateral stocks of one or two of the pledgors, enough has been realized to discharge the claims of the sub-pledgee, and other securities remain in his hands, equity will order a sale of the whole, so that each pledgor may bear his pro rata share of the common burden.[2] A firm of stock brokers, carrying stocks of different customers upon margins as collateral security for the payment of the purchase price at the appointed time of delivery, sub-pledged such stocks to different persons as security for advances. As no customer was able to identify his individual stock as being in the hands of any particular sub-pledgee, any relief was impossible; but in cases where identification of the stock

[1] Cherry *v.* Frost, 7 Lea, 1.

[2] Gould *v.* Central Trust Co. 6 Abb. N. Cas. 381.

could be made, the customers were allowed to follow it, and if sold by the sub-pledgee, to claim the proceeds.[1] A sub-pledgee from a sub-pledgee received certificates of stock of several parties as collateral security, partly for a special loan to the sub-pledgee, and partly for an antecedent debt without more, and was not as to the latter, under the New York rule, a holder for value, in the usual course of business. One of the pledgees, whose collateral securities was thus sub-pledged, was obliged to pay the full value of the stock, in order to return the same to his pledgor. As a surplus resulted from the sale of the other collaterals, after paying the bona fide advance of the second sub-pledgee, the benefit thereof was given the pledgee, as against the claim of the sub-pledgee, on account of the antecedent debt.[2]

§ 327. The Broker's use of Customer's Stock certificates.—Stockbrokers, who have purchased shares of stock for a customer, upon a contract to buy and carry for a certain time, the brokers holding the certificates representing the shares of stock and the customers furnishing margins, are entitled, by commercial custom, to use the particular certificates of stock so purchased and transferred to them, by way of sale, loan or pledge. Shares of stock of companies quoted on the Stock Exchanges of the country, have no particular value one over the other, and no reason exists for retaining any particular certificate received upon a purchase. Stockbrokers, however, are generally required to retain enough shares of any given stock so that they may be able to complete their contracts with their customers at any time agreed. The right to sell, loan, or pledge stocks carried for a customer does not include the right to speculate with it.[3] The same rule is applied as to the want of

[1] Chamberlain *v.* Greenleaf, 4 Abb. N. Cas. 178.

[2] Gould *v.* Farmers' L. & T. Co. 23 Hun. 322.

[3] Levy *v.* Loeb, 85 N. Y. 370; Lawrence *v.* Maxwell, 53 Ib. 19; Stewart *v.* Drake, 46 Ib. 449; Allen *v.* Dykers, 3 Hill, 593; s. c. 7 Ib. 497; Frost *v.* Clarkson, 7 Cow. 24; Wynkoop *v.* Leal, 64 Pa. St. 361; Hubbell *v.* Drexel, 11 Fed. Rep. 115; Price *v.* Grover, 40 Md. 102.

identity, or the absence of "ear marks," in the case of gold certificates[1] and warehouse receipts for grain and other commodities.[2] The duties of the parties to the contract of pledge, as between the broker and his customer, and the use of the certificates of stock, may be governed by agreement. Where such contracts are made in good faith, and not against public policy, nor in contravention of any statute, courts enforce them.[3]

[1] Merchant's Bank *v.* State Bank, 10 Wall. 604.

[2] Bailey *v.* Bensley, 87 Ill. 556.

[3] Baker *v.* Drake, 66 Ib. 518; Lawrence *v.* Maxwell, 53 Ib. 19; Stenton *v.* Jerome, 54 Ib. 480; Taussig *v.* Hart, 58 Ib. 425; Ogden *v.* Lathrop, 66 Ib. 158; Levy *v.* Loeb, 85 Ib. 370; Hubbell *v.* Drexel, 11 Fed. Rep. 115. Where an express agreement is entered into by the parties requiring the broker to keep on hand the stocks or bonds purchased, a substantial compliance therewith must be shown before the broker can recover from his principal. Hardy *v.* Jaudon, 41 N. Y. 619; s. c. 1 Robt. 261.

CHAPTER XXXIII.

THE SALE OF COLLATERAL STOCKS.

§328. The pledgee's sale of stocks, upon default.
329. The pledgee's right of sale under contract.
330. Realization of pledged stock, by trustees for pledgor.
331. The requirements of valid notice and sale.
332. The pledgee, upon his sale of stocks, cannot purchase.
333. The title of the bona fide purchaser at pledgee's sale.
334. Sale by broker carrying stocks, upon default—waiver of notice.
335. The broker's delay in sale, no defense against suit.
336. Measure of damages for wrongful sale by brokers.
337. Measure of such damages in New York and Pennsylvania.
338. The pledgor entitled to profits on unauthorized sale.
339. The broker's right of set-off against damages for conversion.

§ 328. THE PLEDGEE'S SALE OF STOCKS, UPON DEFAULT.—The pledgee holding certificates of stock indorsed with a power of attorney to transfer signed, as collateral security for a loan or discount of commercial paper, is entitled to sell such collaterals, at public sale, upon default of the pledgor, after due demand, and notice of the time and place. Having the legal title to the collateral securities, the pledgee is able to make them available, as the purchaser at such sale has a right to demand, as had the pledgee, transfer of the shares of stock to his own name on the books of the company, and to obtain new certificates.[1] Sub-pledgees of stock certificates, holding the same for value, are also entitled to sell such collateral securities,

[1] Nahring *v.* Bank of Mobile, 58 Ala. 204; Stevens *v.* Hurlburt Bank, 31 Conn. 146; Denton *v.* Jackson, 106 Ill. 433; Langton *v.* Waite, L. R. 6 Eq. 165; France *v.* Clark, L. R. 22 Ch. D. 830; aff. 26 Ib. 257.

upon demand and notice.[1] A private sale is not permitted to be made, even under contract, much below the current market quotation for the stock. Such a sale is open to inquiry and suspicion.[2] A stockbroker has the right to sell stocks which he has bought for a customer, upon the latter advancing margins, where, upon a subsequent depreciation in the market value of the stocks, the customer fails, upon demand, to keep good such margins as agreed. The broker may decline to carry the stocks any longer, and sell the same at his pleasure, without notice. The advances made by the stockbroker being about ninety per cent. of the purchase price of the stock, his right of sale, upon default of the customer to put up further margins, accrues at once.[3] The commission merchant, advancing money for the purchase of property consigned to him has the right to sell the same at such time as he sees proper, to the extent and in payment of his advances.[4]

A pledgee of certificates of stock of a national bank, after transfer had been obtained on the books of the bank, sold the same under a power contained in the contract of pledge. His right of sale was not allowed to be questioned by the pledgor, nor his representatives, although the sale was made to relieve the pledgee of liability from the impending bankruptcy of the bank.[5] Stocks were pledged as collateral security for the payment of a note due in

[1] Gould *v.* Farmer's Loan and Trust Co. 23 Hun, 322; In re Bonney, 8 Daly, 75.

[2] Nahring *v.* Bank of Mobile, 58 Ala. 204.

[3] Hubbell *v.* Drexel, 11 Fed. Rep. 115; Dando's App. 94 Pa. St. 76; Stevens *v.* Hurlburt Bank, 31 Conn. 16; Covell *v.* Loud, 135 Mass. 41. The court (Devens J.) say: "Upon an agreement to keep a margin good to a certain percentage of the current market value of the stock from time to time, the customer, if he makes default, upon demand for further margins, will have no cause for complaint that the broker ceases to hold and carry it, but sells the same without notice."

[4] Butterfield *v.* Stevens, 59 Iowa, 596; Corbett *v.* Underwood, 82 Ill. 324; Moeller *v.* McLasan, 60 Ib. 317; Denton *v.* Jackson, 106 Ib. 433; Weed *v.* Adams, 37 Conn. 378, Howard *v.* Davis, 40 Mich. 546; Brown *v.* Graw, 14 Pet. 479; Field *v.* Farrington, 10 Wall 141.

[5] Magruder *v.* Colston, 44 Md. 349.

ninety days, under a contract by which the pledgee agreed to hold the stocks the same time. The pledgee was allowed to sell the stocks at the expiration of the time stated, although the note representing the loan was entitled to three days of grace.[1] A sale of stocks under a contract of pledge made by a married woman for a loan of money to herself and her husband, although none of the money was used for necessaries or for her separate estate, cannot be disputed when made in good faith, in accordance with the terms of the contract.[2]

§ 329. THE PLEDGEE'S SALE OF STOCKS, UNDER CONTRACT.—Contracts of pledge of stock certificates, entered into by persons, under which a power of sale of the securities upon default is given the pledgee, are valid. The only requirement is, that the pledgee shall act in good faith in such realization of the collateral securities. The pledgor has no cause for complaint, so long as the sale of his property is conducted honestly and according to the contract of which he is a party.[3] A sale of stock below the market price, under power of sale given in the contract, is not enough of itself to charge a broker with the difference, unless it be clearly shown that such sale was made with intent to injure and defraud the pledgor. Such negligence or want of care must be shown in the mode or time or place of sale as to raise a conclusive presumption of the intent to injure the interests of the pledgor, if it is sought to charge the pledgee with liability for loss.[4] If the pledgor has entered into contract giving a power of sale of his collaterals upon default, it is no objection to such sale that he fears that such securities may be sold at a great sacrifice.[5]

Upon the insolvency of the pledgor, the pledgee of stock certificates holding them as collateral security for a call

[1] Rankin *v.* McCullogh, 12 Barb. 103.

[2] Dando's App. 94 Pa. St. 76.

[3] Vail *v.* Hamilton, 85 N. Y. 453; Hubbell *v.* Drexel, 11 Fed. Rep. 115.

[4] Durant *v.* Einstein, 35 Abb. Pr. 223.

[5] Rasch *v.* Creditors, 1 La. Ann. 31.

loan, is entitled to sell his securities, paying any surplus into court for the benefit of those concerned.[1] And stockbrokers who have advanced their own money to purchase stocks for their customers, may, upon the insolvency or bankruptcy of their customer, close the transaction, and sell out the stock without notice, and may claim against the estate for any balance, holding any surplus for the benefit of its representatives.[2] The assignee of an insolvent pledgor may require stock held as collateral security by a creditor to be sold, and such distribution of the proceeds to be made as a court of equity may direct.[3] And where a pledgee holding certificates of stock in trust for the pledgor, was compelled to pay the full value thereof to an assignee in bankruptcy of the pledgor, such payment gave him the legal title to the stock as against the pledgor.[4]

§ 330. Realization of pledged Stocks, by trustees for Pledgee.—Certificates of stock were deposited by way of collateral security, transfers being made on the books of the company to the names of trustees, the certificates being delivered to the pledgee. The contract of pledge provided that, upon default in payment of the loan or of interest, the pledgee should have the right to sell such shares, and apply the proceeds in satisfaction of the debt. The transaction, constituting a mortgage of the shares, and the legal title vesting in the pledgee, upon default in payment, a foreclosure of the shares was decreed, with a short time for redemption.[5] A written assignment of stocks to a trustee empowered to sell enough at discretion to discharge a note due to a third person, if the interest thereon is not paid at a specified day, being a trust to sell, the transferrer

[1] In re Ginnell, 9 N. B. R. 137.

[2] Lacey *v.* Hill, L. R. 8 Ch. 921.

[3] Yeatman *v.* Savings Inst. 95 U. S. 764.

[4] Thompson *v.* Tolland, 48 Cal. 99.

[5] General Credit & Dis. Bank *v.* Glegg, L. R. 22 Ch. D. 549; Redmayne *v.* Foster, L.R. 2 Eq. 467; see Carter *v.* Wake, L. R. 4 Ch. D. 605.

of the stocks to such trustee is not entitled to demand or notice before sale.[1]

§ 331. The requirements of a valid Notice and Sale.—Reasonable notice as to time and place of sale is required of the broker holding stock certificates as collateral security, with margins of the customer, for advances made in the purchase, and of the pledgee receiving such stock certificates as collateral upon a loan or discount of commercial paper, before a valid sale, in the absence of a special contract, can be made. The notice should state the day, time, and place of sale with clearness; but, as the purpose of giving notice is to inform the pledgor of the sale, and give him an opportunity to be present and guard his interests, if this is practically accomplished in good faith, the mode or manner of such notice is immaterial.[2] Notices of sale for two days,[3] or five days,[4] or seven days,[5] are reasonable. Such sales of stock are valid when made on the Stock Exchange of the city in which the transaction of pledge has taken place. A better opportunity is thus offered to secure the current value of the stock than at a public auction.[6] In early cases in New York it was held that a sale at the Stock Exchange was not within the definition of a public sale, but such sales are now supported.[7] The burden of proof is

[1] Murdock *v.* Columbus Ins. Co. 59 Miss. 152; Milliken *v.* Dehon, 27 N. Y. 364.

[2] Conyngham's App. 57 Pa. St. 474; Vanhorne *v.* Gilbough, 10 W. N. C. 347; Gruman *v.* Smith, 51 N. Y. 25; Cameron *v.* Durkheim, 55 Ib. 425; Stenton *v.* Jerome, 54 Ib. 410; Stewart *v.* Drake, 46 Ib. 449; Cortelyou *v.* Lansing, 2 Caines' Cas. 200; Morris Canal & Banking Co. *v.* Lewis, 12 N. J. Eq. 323; Child *v.* Hugg, 41 Cal. 519; Fletcher *v.* Dickinson, 89 Mass. 23.

[3] Stewart *v.* Drake, 46 N. Y. 449; Willoughby *v.* Comstock, 3 Hill, 389; Bryan *v.* Baldwin, 7 Lans. 174.

[4] Vose *v.* Florida Ry. Co. 50 N. Y. 369, 373.

[5] Maryland, Fire Ins. Co. *v.* Dalrymple, 25 Md. 242.

[6] Ravenstock *v.* Torney, 32 Md. 169; Maryland Fire Ins. Co. *v.* Dalrymple, supra: Brown *v.* Ward, 3 Duer, 660; Sparkhawk *v.* Drexel, 12 N. B. R. 450, 470; Warren *v.* Branden Manuf. Co. cited in Cheever *v.* Meyer, 52 Vt. 75.

[7] Dykers *v.* Allen, 7 Hill, 497; Rankin *v.* McCullogh, 12 Barb. 103; Brass *v.* Worth, 40 Barb. 648; Markham *v.* Jaudon, 41 N. Y. 235.

upon the pledgor to show that a proper place for the sale has not been selected.[1] His failure to object to the mode or place of sale within a reasonable time after notice, raises a presumption that he is satisfied, and may amount to a ratification.[2]

§ 332. THE PLEDGEE, UPON HIS SALE OF STOCKS, CANNOT PURCHASE.—The pledgee of certificates of stock is within the rule governing pledgees of negotiable collateral securities that, only under exceptional circumstances, is he permitted to be a purchaser at his own sale, or at a public sale of such stock securities by a third person. A sale of such collaterals by a pledgee to himself, or through an agent or some one acting in his interest, is a breach of the contract of pledge, contrary to good faith, and the pledgor may treat such sale and purchase as a conversion.[3] The pledgor may elect to treat such purchase by a pledgee by himself or through agents, as a nullity, as in no way affecting the relations of the parties to the contract of pledge, and upon payment or tender of the principal debt, is entitled to redeem such collateral securities.[4] The pledgor may, if he

[1] Schepeler *v.* Eisner, 3 Daly, 11.

[2] Vanhorne *v.* Gilbough, 10 W. N. C. 347; Kelsey *v.* Bank of Crawford Co. 69 Pa. St. 426.

[3] Killian *v.* Hoffman, 6 Bradw. 200; Maryland Fire Ins. Co. *v.* Dalrymple, 25 Md. 342; Marye *v.* Strause, 5 Fed. Rep. 483; Carroll *v.* Mullanphy Savings Bank, 8 Mo. App. 249, 254; Middlesex Bank *v.* Minot, 4 Met. 325; Bank *v.* Railroad Co. 8 Iowa, 277; Stokes *v.* Frazier, 72 Ill. 428; Canfield *v.* Minneapolis etc. Assn. 14 Fed. Rep. 801; Brookman *v.* Rothschild, 3 Sim. 155; aff. 5 Bligh, N. S. 165; Gillett *v.* Peppercorne, 3 Beav. 78; Robinson *v.* Mollett, L. R. 7 H. L. 802. Where stock is delivered to a broker for sale, he cannot become the purchaser himself. Parsons *v.* Martin, 11 Gray, 111; Taussig *v.* Hart, 58 N. Y. 425.

[4] Bryan *v.* Baldwin, 52 N. Y. 232; Mott *v.* Havana Bank, 22 Hun, 354; Duden *v.* Waitzfelder, 16 Ib. 337; Wright *v.* Ross, 36 Cal. 414; Stokes *v.* Frazier, 72 Ill. 428; Killian *v.* Hoffman, 6 Bradw. 200; Bank *v.* Dubuque R. R. Co. 8 Iowa, 277; Middlesex Bank *v.* Minot, 4 Met. 325; Pickering *v.* Demeritt, 100 Mass. 416; Day *v.* Holmes, 103 Ib. 306; Maryland Fire Ins. Co. *v.* Dalrymple, 25 Md. 242, 269; Bryson *v.* Ryner, Ib. 424; Hestonville R. R. Co. *v.* Shields, 3 Brewst. 257; Canfield *v.* Minneapolis etc. Assn. 14 Fed Rep. 501; Kimber *v.* Barber, L. R. 8 Ch. 56; Brockman *v.* Rothschild, 3 Sim. 155.

pleases, ratify such sale.[1] Where the transaction of loan, however, is between brokers, members of the same stock exchange, and the stock held as collateral security is sold out "under the rule," the proceedings partake of the character of a foreclosure, and the pledgee is allowed to become the purchaser.[2]

§ 333. THE TITLE OF THE BONA FIDE PURCHASER AT PLEDGEE'S SALE.—The sale and delivery of certificates of stock held by a pledgee under indorsement in blank, so that he has the legal title and apparent ownership, to a bona fide purchaser for value, without notice of equities, vests in the purchaser a good title to the shares of stock, although as between the pledgor and pledgee, the sale of such stock is unauthorized and tortious, and in violation of the contract of pledge. As against such bona fide purchaser for value paid, without notice, on the credit of the title and apparent ownership of the pledgee, the pledgor is not allowed to set up claims to the certificates. As between the pledgor and the purchaser, no privity of contract or relation exists.[3] The rule applies, under like circumstances, to the title of bona fide purchasers, for value, without notice, where the sale is made by one holding such certificates of stock, indorsed in blank, as sub-pledgee.[4] A delivery of certificates of stock, indorsed in blank, was made as collateral security for an advance, but no transfer procured as required by the charter of the company. The pledgee might have sub-pledged the stock, but not having obtained the legal title, he had no right of sale without a previous demand for payment. A purchaser for value, but chargeable with notice of the facts, can, at such

[1] Carroll *v.* Mullanphy Savings Bank, 8 Mo. App. 249, and cases supra.

[2] Quincy *v.* White, 63 N. Y. 370, 376; Newport Bridge Company *v.* Douglas, 12 Bush, 672, 720.

[3] Conyngham's App. 57 Pa.St. 474; Wood's App. 92 Ib. 379; Maryland Fire Ins. Co. *v.* Dalrymple, 25 Md. 342; Little *v.* Barker, Hoffm. Ch. 487; Talty *v.* Freedman's Savings Bank, 93 U. S. 321; Prall *v.* Tilt, 27 N. S. Eq. 393; Warren *v.* Branden Manuf. Co. 52 Vt. 75 *n.*

[4] Mount Holly etc. Co. *v.* Ferree, 17 N. J. Eq. 117.

sale, acquire no greater interest in such shares of stock than the amount of the principal loan; nor can he require a transfer of such shares of stock by the company.[1] Shares of stock were bought by a broker from a minor, fraudulently acquiring possession of the same, at less than one-third their value, and sold immediately afterwards to a purchaser also for much less. The purchase from the minor not being a bona fide transaction in the usual course of business, the second purchaser, chargeable with knowledge of the facts, stood in no better position than his assignor.[2]

§ 334. Sale by Broker carrying Stocks, upon default.—Waiver of notice. — In transactions where a broker purchases and carries stock on the order of a customer, paying about ninety per cent of the cost from his own money, the customer depositing margins and sometimes collaterals, and agreeing to keep such margins at a certain percentage of the current market quotations, if depreciations occur in the value of the stock, and after demand for further margins, the customer defaults, the broker may make an immediate sale of the stocks on the stock exchange, without notice.[3] A customer replied, when asked for additional margins, "I cannot give them to you; I have no money; I cannot put up any more money; this ruins me; I hope it won't ruin you; you must take care of yourself." This was sufficient for the brokers to sell at once.[4] A day's notice to a customer to put up additional margins was insufficient, and a sale thereunder, unauthorized;[5] and where

[1] France *v.* Clark, L. R. 22 Ch. D. 830; aff. 26 Ib. 257.

[2] Anderson *v.* Nicholas, 28 N. Y. 600.

[3] Covell *v.* Loud, 135 Mass. 41 (16 C. L. J. 471); Butterfield *v.* Stevens, 59 Iowa, 596; Markham *v.* Jaudon, 41 N. Y. 235; Baker *v.* Drake, 66 Ib. 518; Gruman *v.* Smith, 81 Ib. 25; Cameron *v.* Durkheim, 55 Ib. 425.

[4] Cameron *v.* Durkheim, supra. A sale was not authorized where the notice was that unless further margins were furnished, the stocks would be "used." Genet *v.* Howland, 45 Barb. 560.

[5] Colt *v.* Owens, 90 N. Y. 368. A day's notice was held sufficient in Milliken *v.* Dehon, 27 N. Y. 364.

the notice was that other margins must be deposited at an early hour on the same day, the sale upon default was not sustained.[1] Where it is impossible to notify the pledgor of intended sale, only at a great expense of time, and to require the consequent delay would be unfair to the broker carrying the stock, no notice need be given.[2]

Written contracts defining the rights of parties, upon default and sale, are resorted to in order to avoid the difficulties and litigation which frequently arise from objections by customers to the validity of sales made by brokers where the latter, having purchased stocks mainly with their own funds, and are carrying the same for their customer, who pays interest upon advances, and agrees to keep certain margins good during the period intervening before and to the time of delivery, and upon default the broker has sold the stocks and losses result which the customer is called upon to pay. By such agreements it is provided that upon default of the customer the broker shall be entitled to proceed at once to sell stocks held by him, without notice, at public or private sale, the customer to be liable for any deficiency, or entitled to any surplus, upon payment of proper charges. Such contracts are valid, when made in good faith, and fairly executed.[3] Where a power of sale, public or private, without notice, is given upon margins falling below a certain percentage of the market value, the broker may sell the stock purchased by him for his customer, and paid for mainly out of his own funds, whenever

[1] Burkett *v.* Taylor, 86 N. Y. 618.

[2] City Bank *v.* Babcock, Holmes, 180.

[3] Child *v.* Hogg, 41 Cal. 519; Hyatt *v.* Argenti, 3 Ib. 151; Hamilton *v.* State Bank, 22 Iowa, 306; Clark *v.* Bouvain, 20 La. Ann. 70; Bryson *v.* Rayner, 25 Md. 424; Maryland Ins Co. *v.* Dalrymple, Ib. 242, 264, 269; Stenton *v.* Jerome, 54 N.Y. 480; Wicks *v.* Hatch, 62 Ib. 535; Quincy *v.* White, 63 Ib. 158; Ogden *v.* Lathrop, 65 Ib. 535; Baker *v.* Drake, 66 Ib. 518; Colket *v.* Ellis, 10 Phila. 375. In early cases the power of sale given in such contracts was not sustained, as being a waiver of an equity of redemption. Campbell *v.* Parker, 9 Bosw. 322; Hanks *v.* Drake, 49 Barb. 186; Wilson *v* Little, 2 N. Y. 443, 448.

the market renders it prudent, not only for the protection of his own interest, but also for the benefit of his customer.[1]

§ 335. The Broker's delay in Sale, no defense against Suit.—The broker carrying shares of stock purchased by him for a customer, upon a deposit of margins, as security for his advances, is under no obligation to sell the stocks in order to provide funds to pay the debt of the customer. The customer is not discharged as to his personal obligation, by reason of mere neglect of the broker to sell the stocks, although in the meantime they have depreciated in value, or even become worthless. At any time, upon the equitable terms of paying his debt to the broker, the customer may require a transfer of the certificates representing the shares of stock. or during the option, may require the closing of the deal, receiving any surplus from the sale of the stocks, or paying losses.[2] Nor is it any defense for the customer, as against an action by his brokers for moneys paid at his request and services performed, that although the brokers gave notice they would no longer carry the stocks unless further margins were furnished, and the margins were not sent, continued to hold such stocks until they became valueless. Had the market advanced after a sale of the stock, the customer would probably have insisted that the brokers were liable for a wrongful sale.[3] The failure to sell collateral stocks after the entry of judgment on the principal debt, will not entitle the pledgor to a return of the collaterals, so long as the judgment remains unpaid.[4]

§ 336. Measure of damages for wrongful Sale by Brokers.—A customer is entitled to his action for

[1] Wicks *v.* Hatch, 62 N. Y. 535.

[2] O'Neil *v.* Wightman, 87 Pa. St. 394; Williamson *v.* McClure, 37 Ib. 402; Lawrence *v.* Maxwell, 53 N. Y. 19; Taggard *v.* Courtenius, 15 Wend. 155; Rozet *v.* McClellan, 48 Ill. 345; Granite Bank *v.* Richardson, 7 Met. 407; Robinson *v.* Hurley, 11 Iowa, 410; Richardson *v.* Insurance Co. 27 Gratt. 749.

[3] Essex *v.* Linderman, 71 Pa. St. 76.

[4] Fisher *v.* Fisher, 98 Mass. 303.

damages against his broker, where the latter has sold the collateral stocks without demand for further margins, or for payment of the debt for which certificates of stock are held as collateral security, or has failed to give reasonable notice of the time and place. If the customer or pledgor suffers damage by the unauthorized sale of the broker or pledgee, the latter are liable to make good the loss.[1] Such damages in exceptional cases may exceed the value of the stock at the time of the conversion, provided they are a proximate result, and are included in a just compensation.[2] The measure of damages resulting from unauthorized sales by brokers includes all those arising or flowing from the wrongful act, being the value of the stocks at the time of the conversion, interest to judgment, and any special damage legitimately arising out of matters in existence at the date of the tort.[3] Or the pledgor may recover a sum of money sufficient to buy new shares, with allowance for dividends paid, and interest, or he may have a re-conveyance of the shares.[4]

The rule of damages applied, where a broker carrying shares of mining stocks, usually of uncertain value, together with margins, as security for his advances, interest and commissions, makes a tortious sale of such shares, is the highest market value of the stock at any time between the conversion and the verdict, with interest.[5] Where stocks were obtained by a minor fraudulently, and sold for one-third their value, the purchaser being chargeable with knowledge, the measure of damages recovered by the owner upon a refusal of the purchaser to re-transfer, was the value of the stock and interest from the commencement of the action.[6] A sale of certificates of stock, held as collateral security, to a third person, was made by the pledgee, upon default, upon a pre-arranged contract, and refusal to

[1] Denton *v.* Jackson, 106 Ill. 433.

[2] Seymour *v.* Ives, 48 Conn. 109; Bates *v.* Wiles, 1 Handy, 532

[3] Boylan *v.* Huguet, 8 Nev. 345.

[4] Fowle *v.* Ward, 113 Mass. 548.

[5] Dent *v.* Holbrook, 54 Cal. 145.

[6] Anderson *v.* Nicholas, 28 N. Y. 600.

allow the pledgor an additional day's time, although the latter offered funds as promised, and demanded return of the collateral stocks. Such a sale being clearly inequitable, the pledgor was allowed to recover his damages.[1]

§ 367. Measure of such damages in New York and Pennsylvania.—The measure of damages where there has been an unauthorized sale of stocks carried by a broker on margins furnished by a customer, for speculative purposes, is held, in New York, to be the market price of the stocks from the time of such sale to a reasonable time after notice thereof is received by the customer.[2] If, in the meantime, the stock has advanced in value, the customer is entitled to the difference, although where it has declined, the customer, suffering in fact no injury by such sale, is not allowed to claim a greater benefit than if the wrongful act had never been committed.[3] The question of what is a reasonable time is governed by the circumstances of each case, and is generally left to a jury to decide.[4]

The rule approved in Pennsylvania as to the measure of damages for conversion of stock in the absence of any trust relation between the parties, or of any obligation to deliver specific shares, is the market value of the stock on the day it should have been delivered, with interest thereon, to the

[1] Stevens *v.* Bank, 31 Conn. 146.

[2] Baker *v.* Drake, 53 N. Y. 211; s. c. 66 Ib. 518; Thayer *v.* Manley, 73 Ib. 305; Gruman *v.* Smith, 81 Ib. 25; Colt *v.* Owens, 90 Ib. 368; Roberts *v.* Berdell, 61 Barb. 37. Overruling the rule formerly prevailing in New York by which the measure of damages recovered by the customer was the highest market price for which such stock had been sold in the interval between the conversion, and the day of trial, and even during the progress of the trial. Allen *v.* Dykers, 3 Hill, 593; s. c. 7 Ib. 497; Wilson *v.* Little, 2 N. Y. 443; Romaine *v.* Allen, 26 Ib. 309; Burt *v.* Dutcher, 34 Ib. 493; Markham *v.* Jaudon, 41 Ib. 235; Morgan *v.* Gregg, 46 Barb. 183; Nauman *v.* Caldwell, 2 Sweeney, 212. The like rule was declared in an early case in Pennsylvania. Bank of Montgomery *v.* Reese, 26 Pa. St. 143.

[3] Gruman *v.* Smith, 81 N. Y. 25.

[4] Baker *v.* Drake, 53 N. Y. 211; s. c. 66 Ib. 518; Colt *v.* Owens, 90 N. Y. 338.

time of trial, being the rule of damages as on contracts of other marketable commodities, where there has been no fraud, and the parties stand *in equali jure*.[1] Upon an action of assumpsit for the value of stock disposed of at an unauthorized sale, the tort being waived, the recovery is limited to the value of the stock at the time of the conversion, with interest.[2] Where such stocks are held in trust under a contract of pledge, the dividends and accretions belonging to the pledgor, an unauthorized sale makes the pledgee chargeable with what would have been received had the stocks been retained until the equity of redemption of the pledgor was foreclosed by sale, after notice, in the manner prescribed by law; and the measure of damages in such actions is the value of the stock at the highest rate it has at any time since attained in the market. This rule of damages is strictly confined to trust transactions, the other rule being applied where the facts require it.[3]

§ 338. The Pledgor entitled to Profits on unauthorized Sale.—Upon a wrongful sale of stocks by a pledgee made before the maturity of the principal note, and a tender of the debt, and demand for the collaterals is made by the pledgor at maturity, an offer by the pledgee of like shares of the same stock, which, in fact, he has purchased subsequently to the unauthorized sale at a great depreciation in price, is insufficient. The pledgor is entitled, at his election, to decline to receive such shares, and may bring an action against the pledgee for the profits realized upon the unauthorized sale. The decline in value of the stocks pledged subsequently to the sale forms no defense to such action.[4] Certain certificates of stock, properly in-

[1] North *v.* Phillips, 89 Pa. St. 250; Huntington etc. Co. *v.* English, 86 Ib. 257.

[2] Wagner *v.* Peterson, 83 Pa. St. 233.

[3] Neiler *v.* Kelly, 69 Pa. St., 403; Work *v.* Bennett, 70 Ib. 484; North *v.* Phillips, 89 Ib. 250.

[4] Fowle *v.* Ward, 113 Mass, 548; Shaw *v.* Spencer. 100 Ib. 382; Dykers *v.* Allen, 7 Hill, 497; Rankin *v.* McCullough, 12 Barb. 103; Law-

dorsed, were delivered to stockbrokers as collateral security for a loan. Before maturity of the loan, the pledgor contracted to sell the stock, and tendered the loan with interest for the full time, demanding the collaterals. The pledgees, meanwhile, had sold the stock, and refused to accept payment or to reconvey the stock until the maturity of the loan; and the principal had to pay his vendee differences. At the time fixed for payment, the brokers returned a like number of shares of stock, which they had purchased at a great decline in price. The pledgor sued for the profits which had been realized. In the absence of express contract, the pledgee having no authority to sell until the maturity of the principal loan, the pledgor was entitled to charge him with the price obtained at such sale if he found

rence *v.* Maxwell, 53 N. Y. 19; Taussig *v.* Hart, 49 Ib. 301; Conyngham's App., 57 Pa. St. 474; Hunsaker *v.* Sturgis, 29 Cal. 142; ex parte Dennison, 3 Ves. 555. The reasons of the rule are stated in Taussig *v.* Hart, supra, in which it was agreed that the broker should buy and sell stocks, as the customer should direct, upon a margin of ten per cent. and the benefit of dividends, all purchases and sales to be regular. The broker speculated in the stock, and bought it in at a decline. The court (Rapallo, J.) say: "The subsequent acquisition by the brokers, after the stock had fallen to a very low figure, of a sufficient number of shares to replace those which they had held for account of their principal, did not relieve them from liability. Such re-acquired stocks were never accepted by the principal, and he was in fact ignorant of the transactions. To allow a broker to sell his customer's stock without authority and speculate upon replacing it at a lower price would be encouraging speculations by agents, at the risk of their principals, totally inadmissible under familiar rules. Should the stock rise largely in price after the broker had thus divested himself of all control over the shares which he had purchased on the order of his principal, the broker might be unable to replace the shares, and the principal would have no remedy except a personal claim against the broker. This clearly is not what is contemplated under an agreement to buy and carry stocks. The customer does not rely upon an engagement of the broker to procure and furnish the stocks when required, but to purchase and hold the number of shares ordered, subject to the payment of the purchase price." The customer was allowed the value of the stock on the day of sale.

it to his interest so to do, notwithstanding any subsequent reduction in the market value of the stock.[1]

§ 339. THE BROKER'S RIGHT OF SET-OFF AGAINST DAMAGES FOR CONVERSION.—Upon a contract by which a broker agrees to purchase certain stocks for a customer, and to carry the same, holding the stocks and margins deposited by the customer as security for his advances there is on the part of the customer an agreement, express or implied, that the margin shall, if the stock depreciates, be replenished and kept good, upon demand, and that, upon the failure so to do, the stock may be sold upon reasonable and customary notice. A sale without such notice is a conversion and does not bind the pledgor, who, in a suit by the broker for a deficiency, may insist upon a full indemnity for his loss or injury. This, however, is not necessarily the whole amount of such claim of the broker.[2] Nor will an unauthorized sale of stock certificates by a pledgee, no demand or notice being given, vest the immediate right to their possession in the pledgor, so as to entitle him to maintain an action of trover for the whole value of the shares, or for nominal damages.[3] But a broker employed to purchase and carry stocks, and under agreement or usage, holding the title thereto in his own name, is not entitled to maintain an action against his customer for not furnishing moneys to pay for the stocks, without demand of payment, and tender of the stocks. Should the broker, under such circumstances, sell the stocks without notice, thereby disabling himself from making a transfer thereof, such sale is a conversion, and the broker loses any right of action he might otherwise have had.[4]

[1] Langton *v.* Waite, L. R. 6 Eq. 165. Upon hearing on the appeal, it appeared that the pledgor, after receiving the substituted stock from the broker, sold the same, so that it was impossible for him to re-transfer the stock in accordance with the offer in his bill. He was not permitted any more than the pledgee to satisfy his obligation by transferring a like amount of the same stock, and his bill was dismissed, Langton *v.* Waite, L. R. 4 Ch. 402.

[2] Vail *v.* Hamilton, 85 N. Y. 453.

[3] Nahring *v.* Bank of Mobile, 58 Ala. 20; Halliday *v.* Holgate, L. R. 3 Ex. 299.

[4] Merwin *v.* Hamilton, 6 Duer, 244.

CHAPTER XXXIV.

THE RIGHTS OF THE PLEDGOR OF STOCKS.

§340. Relief of the pledgor of collateral stocks, in equity.
341. Relief of pledgor by specific performance, by redemption, etc.
342. Limitations of pledgor's relief in equity.
343. Pledgor's right to redeem stock defeated by laches.
344. The recovery at law of the pledgor of stocks.
345. No action of trover by pledgor on pledgee's transfer.
346. Upon discharge of debt, pledgor entitled to his collateral stocks.

§ 340. Relief of the Pledgor of Collateral Stocks, in equity.—Courts of equity take cognisance of cases arising from the use of certificates of stock as collateral security, upon acknowledged grounds of equitable jurisdiction. Generally, the pledgor of collateral stocks has a full and complete remedy at law for wrongful sales and transfers by the pledgee, and resort to equity is not necessary, and is not permitted. The value of the shares of stock represented by the certificates is fixed by the daily transactions on the Stock Exchanges, and is easily arrived at, and the facts thus established are as available at law as in equity. Equity however, will in proper cases, decree specific performance of a contract for the delivery of particular stocks having a special value; and in other ways aid the parties to the contract of pledge.[1] Courts of equity will aid the pledgor,

[1] Fraser *v.* Charleston, 11 S. C. 486; Hathaway *v.* Fall River Bank, 131 Mass. 15; Newton *v.* Fay, 10 Allen 505; Pinkerton *v.* Manchester R. R. Co., 42 N. H. 424; Hasbrouck *v.* Vandervoort, 4 Sandf. 74; Treasurer *v.* Commercial Mining Co., 23 Cal. 391; Strasbourg *v.* Echternact, 21 Pa. St. 220; Canfield *v.* Minneapolis etc. Assn. 14 Fed. Rep. 801; Ross *v.* Union Pac. Ry. Co., 1 Woolw. 26; Fallon *v.* Railroad Co., 1 Dill. 121; Brick *v.* Brick, 98 U. S. 514; Hayward *v.* National Bank, 96 Ib. 611;

where certificates of stock, indorsed with power of attorney to transfer, have been delivered as collateral security, and transferred upon the books of the company, by requiring discovery of the real interest of the pledgee in the stock. Testimony will be heard as to the considerations and purposes of the transfer, and upon the equitable terms of payment of the principal debt, a re-conveyance of the shares of stock is decreed.[1] Where the evidence is in favor of the claims of the pledgee to retain the stock, dismissal of the bill is generally ordered.[2] A pledgor of collateral stocks, or one who has acquired his interest, may bring a suit in equity to set aside an invalid sale of such securities, where the pledgee, through its agent, became the purchaser.[3] Equity will compel a replacement of stocks held as collateral security, lost through the gross negligence of the pledgee, or payment of the value;[4] and will control the application of securities held from different pledgors by sub-pledgees, so as to carry out equitable principles in the resort to such securities, and distribution of proceeds.[5]

§ 341. Relief of Pledgor by specific Performance, by redemption, etc.—The remedy of the pledgor, for an unauthorized transfer of his stock, or its misappropriation or tortious sale, is by an action at law, but cases of a special or particular stock, however, may arise, in which courts of equity will decree a specific performance of an agreement to convey or to replace or to transfer specific stocks where the ordinary rules of damages in actions at law would be altogether insufficient. The rule is usually enforced in regard to shares of stock of mining companies, which occupy

France *v.* Clark, L. R. 22 Ch. D. 830; Shaw *v.* Fisher, 5 DeG. M. & G. 596.

[1] Newton *v.* Fay, 10 Allen, 505; Burke's App., 99 Pa. St. 350.

[2] Burke's App., 99 Pa. St. 350.

[3] Canfield *v.* Minneapolis etc. Assn. 14 Fed. Rep. 801.

[4] Fowle *v.* Ward, 113 Mass. 548.

[5] Chamberlain *v.* Greenleaf, 4 Abb. N. Cas. 178; Samuels *v.* Boykin, 27 Ga. 47; Barnes *v.* Mott, 64 N. Y. 397.

an uncertain position on the public exchanges, and are generally of changing, indeterminate value, so that it is difficult to arrive at their real worth. Such shares of stock may also possess a particular and special value to certain persons.[1] A bill to redeem shares of stock, brought by the assignee of an insolvent pledgor, was supported, where the pledgee claimed to retain the collateral securities under a contract for liabilities other than the principal note discounted at the time of the pledge, and in which a tender of the amount of the principal note was made, upon the equitable terms of payment of the debt, with interest, after deducting dividends collected by the pledgee. Such a cause may be referred to a master to state an account, where necessary.[2] In a redemption suit, where a mortgage of certain shares of stock for a term of years to secure the purchase of like stock at the end of the term, and the payment of interest in the meantime, the mortgagee had permitted the transaction to continue after the end of the term, the stock then heavily declining in value, the mortgagor was allowed to redeem by purchasing stock at the time of the trial, not being charged with the value thereof at the expiration of the term, the mortgagee having waived the obligation to purchase at that particular time.[3] An authorized pledge of stock of a third person was made by stockbrokers to a bank for a specific loan, the brokers giving a promissory note as personal evidence of indebtedness, the bank being chargeable with notice that the loan was for the third person, and to be used in paying part of the purchase money of the stock, and that the stock belonged to such third person. A tender of the loan was made, but the bank

[1] Cushman *v.* Thayer Mnfg. Co., 76 N. Y. 365; White *v.* Schuyler, 1 Abb. N. S. 300; Philip *v.* Barker, 2 Barb. 608; Purchase *v.* New York Exch. Bank, 3 Robt. 164; Middlebrook *v.* Merchan's' Bank, 41 Barb. 481; s. c. aff. 3 Abb. App. 295; Buckmaster *v.* Consumers' Ice Co., 5 Daly, 313; Treasurer *v.* Commercial Mining Co., 23 Cal. 391.

[2] Hathaway *v.* Fall River Bank, 131 Mass. 15.

[3] Blyth *v.* Carpenter, L. R. 2 Eq. 501.

claimed a lien on the stock for other loans to the stockbrokers remaining unpaid. The owner of the stock was allowed to redeem the same or recover damages, although the power of attorney of the stockbroker was absolute in its terms. Chargeable, however, with knowledge of the limited power of the agent, the bank could acquire no greater rights than those actually given.[1]

§ 342. Limitations of Pledgor's relief in equity.— The pledgor, when he seeks relief in equity, is required to do equity. Where a bona fide advance has been made on the collateral securities deposited, or other valuable consideration, equity requires that the debt shall be first paid before it will lend its aid to obtain a return of the securities. In this, it carries into effect the rule that equity follows the law. Although the sale or sub-pledge of stock collateral stocks be a tortious, unauthorized act, or if it be before the power of sale given by the contract of pledge has come into force, default not having occurred, the contract of pledge is not annihilated, and law, as well as equity, requires that as against any claim for damages arising therefrom, the amount of the bona fide loan made thereon shall be set-off as a counter-charge.[2] Nor will equity aid a trustee, holding shares of a company for an adult cestui que trust, who paid the money, but to whom upon the execution and presentation of a transfer by the trustee, the company refused to transfer the shares. The company subsequently became bankrupt, and the trustee claimed an indemnity from the cestui que trust against future calls. As no calls had been made, and no proof was offered that any would be made, no ground for equitable relief was shown, and the bill of the trustee was dismissed.[3] The receiver of an insolvent firm of stockbrokers is not required

[1] Talmadge *v.* Third Nat. Bank, 91 N. Y. 531.

[2] Hathaway *v.* Bank, 131 Mass. 15; Newton *v.* Fay, 10 Allen, 505; Halliday *v.* Holgate, L. R. 3 Ex. 299.

[3] Hughes-Hallet *v.* Indian Mines Co., L. R. 20 Ch. D. 561.

in equity to redeem the stock sub-pledged by the firm by paying the debts due to the sub-pledgees, and will have no right to do so at the risk of loss to the general creditors. Even a tender of his debt made to him by a pledgor of such stock so sub-pledged, imposes no special duty upon such receiver to redeem the stock for the benefit of the pledgor. The rule is otherwise where such stock is in the hands of the receiver. Upon paying his debt, the pledgor thereof is equitably entitled to a return of his collateral stocks, and such receiver will be required to deliver them.[1] Equity will not take jurisdiction of an account arising out of a transaction in collateral stock securities, upon the ground of settlement of complicated accounts, where one item only is in dispute.[2]

§ 343. PLEDGOR'S RIGHT TO REDEEM STOCKS DEFEATED BY LACHES.—The pledgor of certificates of stock may, however, lose his claim to equitable relief by laches. If he permits any claim or right he may have to redeem shares of stock pledged as collateral security to sleep for years, and then, upon an increase in the market value of such stock, tenders the amount of his indebtedness in order to secure the advantage of the rise, courts of equity refuse to aid him to obtain a return of his collateral securities. A bill was brought in equity to redeem mining stocks delivered to a bank as collateral security for a loan made in good faith. The stocks, upon default in payment of the loan, were sold under a valid contract of pledge, and purchased by three directors of the bank at a price above the market quotations. The proceeds of the sale discharged the loan, of which the pledgor was informed, and made no objection. The stocks increased in value, and four years afterwards, the pledgor gave notice to the bank that he desired to redeem the collateral securities; and upon refusal, sued but

[1] Chamberlain *v.* Greanleaf, 4 Abb. N. Cas. 178.

[2] Durant *v.* Einstein, 35 How. Pr. 223.

unsuccessfully. Having failed to act with diligence before any material change in the circumstances or in the value of the stock had intervened, the pledgor had lost any right which he might have had to repudiate the sale and recover the stocks.[1] Seven years' delay is laches.[2] A delay of eleven years constituted a bar to any equitable relief of a pledgor, who deposited shares of stock as collateral security for a note, and was seeking to take advantage of a considerable rise in the market value of the stock.[3] An application for equitable relief, brought nineteen years after the contract of pledge, was not favored, the principal evidence of the debt, promissory notes, and equitable remedy being barred by the statute of limitations.[4] In Louisiana, however, shares of stock pledged as security for a loan constitute a constant acknowledgment of the debt, and interrupt prescription during the time the pledged securities remain in possession of the pledgee.[5]

§ 344. The recovery at law of the Pledgor of Stock.—Actions of trover founded upon conversion of shares of stock, may be brought by a pledgor, whose stocks have been sold without authority, or compliance with the established customs and usages of stock exchanges. The pledgor may recover damages, subject generally to recoupment by the pledgee of the amount of his loans.[6] The

[1] Hayward *v.* National Bank, 96 U. S. 611.

[2] Adams *v.* Sturges, 55 Ill. 468.

[3] Waterman *v.* Brown, 31 Pa. St. 161.

[4] Robert *v.* Sykes, 30 Barb. 173.

[5] Conger *v.* City of New Orleans, 32 La. Ann 1250; Blanc *v.* Hertzog, 23 Ib. 293; Citizen's Bank *v.* Knapp, 22 Ib. 117; Police Jury *v.* Donaldo, Ib. 107; City Bank *v.* Johnson, 21 Ib. 128.

[6] Payne *v.* Elliott, 54 Cal. 339; McCalla *v.* Clark, 55 Ga. 53; Nahring *v.* Bank of Mobile, 58 Ala. 204; Anderson *v.* Nicholas, 28 N. Y. 600; Ayres *v.* French, 41 Conn. 151; Boylan *v.* Huguel, 8 Nev. 352; Kuhn *v.* McAllister, 96 U. S. 89. Contra: Neiter *v.* Kelly, 69 Pa. St. 407. The mere pledge of stocks purchased by a broker for a customer on margins, will not amount to a conversion, Chamberlain *v.* Greenleaf, 4 Abb. N. Cas. 178. Assessments paid on the stock by the pledgee are proper matters by way of recoupment or in mitigation of damages on the trial of an action of trover for conversion of stock. McCalla *v.* Clark, supra.

necessary requirement that the whole present interest in the property sought to be recovered, should be in the pledgor, to sustain an action of trover, defeats such action in cases where there has been an unauthorized sale of stock certificates, if no payment or tender of the principal debt has been made. Until the pledgor has paid or tendered his debt, he is not entitled to a re-delivery of stock certificates held as collateral security. The entire present interest is vested in the pledgee, and no presumption arises that the pledgee, even by a wrongful sale, consents to revests in the pledgor an immediate interest or right in the pledged securities sufficient to sustain an action of trover.[1] Under this rule, where a pledgee was vested with the legal title to the shares of stock held as collateral security, the pledgor was not entitled to maintain an action of trover.[2]

§ 345. No action of trover by Pledgor on Pledgee's Transfer.—Actions of trover brought by pledgors are not supported as against pledgees of certificates of stock, indorsed with power of transfer, and who have made transfers to third persons for convenience upon proper considerations, where still retaining control thereof. Where mining stocks were held as collateral security, a transfer of some of the shares to third persons was made in order to relieve the pledgee from the supposed injury to his credit of carrying so much mining stock. The new certificates, indorsed in blank, were retained by the pledgee, who was ready to re-deliver the same upon payment of the debt. The transaction not amounting to a conversion of the certificates of stock, and no tender of payment, demand for the stock and refusal to convey having been made, the pledgor's action of trover was not sustained.[3] Nor was a transfer of stock a conversion thereof,

[1] Halliday *v.* Holgate, L. R. 3 Ex. 299; Johnson *v.* Stear, 15 C. B. N. S. 330.

[2] Nahring *v.* Bank of Mobile, 58 Ala. 204.

[3] Day *v.* Holmes, 103 Mass. 306.

where a pledgee placed the same, by surrender of certificates and the issue of new certificates in the name of a third person so that such stock being intended as a security might not become a burden.[1] It was held not a conversion, so as to make a partnership liable, where one partner holding stocks for a third person, with power of sale, transferred the stock to the partnership name, the other members having no interest in the transaction.[2]

§ 346. Upon discharge of Debt, Pledgor entitled to his Collateral Stocks. — In common with other pledgees, the holders of certificates of stock, transferred as collateral security, are not entitled to retain possession of the collaterals after payment of the principal debt by the pledgor. The same rule applies where a valid tender of the debt has been made at maturity. A refusal to re-deliver such collateral securities upon such tender, because of an unwarranted claim to retain the stock, is a conversion thereof by the pledgee.[3] Where a sub-pledgee had sold, under a contract of pledge, stock certificates, indorsed with power to transfer, upon default of the pledgee, who had transferred the stock held by him as collateral security separate from the debt, and thus had incapacitated himself from returning the same on payment, the pledgor was allowed to maintain an action for the conversion, without a tender of the debt for which the stock was originally pledged, as against the sub-pledgee, he not being a holder for value, in the usual course of business, on account of usury in his loan.[4] A pledgee of stock certificates as collateral security has no more right to retain them after the principal debt is tendered than a bank has to retain notes offered for discount and refused, or no more than if upon the stock being offered as collateral security for the payment of principal notes, discount of the notes is refused.[5]

[1] Heath *v.* Griswold, 18 Blatchf. 555.
[2] Adams *v.* Sturges, 55 Ill. 468.
[3] Talmadge *v* Nat. Bank, 91 N. Y. 531; McCalla *v.* Clark, 55 Ga. 53.
[4] Felt *v.* Heye 32 How. Pr. 359.
[5] Hathaway *v.* Bank, 131 Mass. 15.

CHAPTER XXXV.

THE BROKER'S OPTION CONTRACT.

§347. The broker's option deal for his customer.
348. The "seller's option" contract valid.
349. Option deals, to be settled upon differences, illegal.
350. The validity of option contracts, as shown by evidence.
351. Evidence of intention, upon action on contract by broker.
352. The broker's option contract valid, upon purchase of stock.
353. Other option contracts held valid.
354. The broker's option deals on boards of trade.
355. The options known as puts, calls, straddles, and shaves.

§347. THE BROKER'S OPTION DEAL FOR HIS CUSTOMERS.—The contracts made by stockbrokers and other brokers operating upon the commercial Exchanges of the country, made upon the order of customers, depend for their validity on the character of the options which are traded in, and the intentions of the parties. The speculative option known as "seller's" option, is the most common in use. It gives the seller an option of delivery during the time specified therein, with an express condition to deliver the commodity sold at a time fixed by the contract. Where this contract is made bona fide by the parties thereto, it is valid, and claims arising thereunder are enforced by the courts without exception. The validity of such option is not affected, where one of the parties acts in good faith and with the intention of fulfilling the same, by the fact that the other secretly intends not to deliver or receive any property at the expiration of the option, but to close the deal by paying differences. The broker is entitled to recover from his customer, where deals in valid options have been made upon exchanges, upon orders of customers, and losses have oc-

curred, which the broker has paid upon request, the sums advanced and his commissions, although it was never intended to deliver or receive any property upon such deals. The broker, however, cannot recover upon any contract entered into between himself and the customer providing for speculations upon the Exchanges in stocks or other commodities, where the intention of both parties at the making of the contract was that the only deals were to be mere wagers on future prices, without any delivery, or the option deals, known as "puts" and "calls," condemned and rendered void by statute. Courts refuse to aid the parties to enforce payment of losses incurred upon such illegal contracts; and the negotiable paper given in settlement thereof, is, under the statutory provisions of several states, also void, even in the hands of holders for value, without notice.[1]

The broker making purchases or sales of property upon option contracts on the Exchanges upon the order of his customer, comes within the rule of agency that "what a man may do by himself he may do by another. A man may employ a broker to make a contract for him, and to execute it for him in any manner in which it would be lawful for him to make and execute it if acting for himself in person. Any man, although not a dealer in wheat, may therefore lawfully employ a broker on the Exchange to sell wheat for him for delivery at a future time, and to execute the contract for him by purchasing upon the market the wheat for delivery when the time arrives for its delivery, or by settling with the purchaser upon the payment of the difference between the contract price and the market price, if the pur-

[1] Rountree *v.* Smith, 108 U. S. Rep. 269; Gilbert *v.* Guagar, 8 Biss. 214; Clark *v.* Foss, 7 Ib. 551; Jackson *v.* Foote, 12 Fed. Rep. 37; Union Nat. Bank *v.* Carr, 15 Fed. Rep. 458; Cobb *v.* Prell, Ib. 774; Bartlett *v.* Smith, 13 Ib. 263; Lehman *v.* Strassberger, 2 Woods, 557; Rumsey *v.* Berry, 65 Me. 574; Bigelow *v.* Benedict, 77 N. Y. 202; Cook *v.* Davis, 53 Ib. 318; Wilhelm *v.* Carr, 80 N. C. 294; Brua's App. 55 Pa. St. 294; North *v.* Phillips, 89 Ib. 115; Dickson *v.* Thomas, 93 Ib. 278; Cole *v.* Milmine, 88 Ill. 349; Pixley *v.* Boynton, 79 Ib. 351; Everingham *v.* Meighan, 55 Wis. 354.

chaser shall waive the execution of the contract by the delivery of the wheat, according to its terms."[1]

§ 348. THE "SELLER'S OPTION" CONTRACT, VALID.—A contract for the future delivery of commodities, whether stocks, grains, provisions, or other property, at a time certain absolutely, but with what is called a "seller's option" for a definite period before that time depends for its validity upon the mutual intentions and purposes of the parties. The option may refer to the fact of delivery, or merely to the time of delivery. If it be the bona fide intention of the vendor to deliver, and of the vendee to receive, and the option consists only in the time of delivery within a certain period, the contract is valid.[2] The validity of the contract where the intention of the parties at the time of making such contract, was, that the only option should be as to time of delivery, is not affected by a subsequent agreement to close the deal by payment of differences between the contract price and market value on or before the day of settlement.[3] Nor will the fact that the vendor has not, at the time of making such contract of sale, the stocks, grain, or other property in his possession, nor does not expect to have them on hand and has no means of getting the same,

[1] Kent *v.* Miltenberger, 13 Mo. App. 503 (Thompson J.).

[2] Jackson *v.* Foote, 12 Fed. Rep. 37; Melchert *v.* American Union Tel. Co. 11 Ib. 193; Union Nat. Bank *v.* Carr, 15 Ib. 438; Porter *v.* Viets, 1 Biss. 177; Clarke *v.* Foss, 7 Ib 540; Pixley *v.* Boynton, 79 Ill. 351; Wolcott *v.* Heath, 78 Ib. 433; Logan *v.* Musick, 81 Ib. 415; Cole *v.* Milmine, 88 Ib. 349; Webster *v.* Sturges, 7 Bradw. 560; Calderwood *v.* McCrea, 11 Ib. 543; Taggart *v.* Sawyer, 14 Bush. 727; Rumsey *v.* Berry, 65 Me. 574; Gregory *v.* Wendell, 39 Mich. 340; Giles *v.* Bradley, 2 Johns. Cas. 253; Disborough *v.* Neilson, 3 Ib. 81. And in stock operations: Bigelow *v.* Benedict, 70 N. Y. 202; Cook *v.* Davis, 53 Ib. 318; Frost *v.* Clarkson, 7 Cow. 24; Cassard *v.* Hinman, 1 Bosworth, 207; Noyes *v.* Spaulding, 27 Vt. 420; Hibblewhite *v.* McMornie, 5 M. & W. 4; Shales *v.* Seignoret, 1 Ld. Raym. 440; Ashton *v.* Dakin, 4 H. & N. 869; Mortimer *v.* McCullen, 7 M & W. 20.

[3] Melchert *v.* American Union Tel. Co. 11 Fed. Rep. 193; Gilbert *v.* Guagar, 8 Biss. 214; Clarke *v.* Foss, 7 Ib. 540.

except by purchase on the market on or before the day of the promised delivery under the contract, render it invalid, if there be a bona fide intention to make such delivery.[1] The advance, as a part of such contract, of margins by the customer to cover fluctuations of prices in the stocks, or grain, or other property, for which the option is sold, pending delivery or settlement at the time fixed by the contract for the closing of the option, according to the rules and usages of the Exchange upon which the deal is made, is a valid transaction.[2]

§ 349. Option contracts, to be settled upon Differences, illegal.—The intentions of the parties to the contract is of controlling effect as to the validity or invalidity of the trades made by a broker for his customer. A broker who agrees with his customer to trade for him on the Exchange so that all deals shall be settled by the payment of differences only, and who makes such sales or purchases with third parties upon the Exchange with the like intent, cannot enforce any claim founded upon losses in carrying out the contract, as the same is illegal and void, and comes (in some states) within statutory enactments against gaming. The form in which such option contracts upon speculative deals is drawn up is not conclusive of the character of the deals, as a jury is authorized to look into

[1] Sawyer *v.* Taggart, 14 Bush, 727; Williams *v.* Tiedeman, 6 Mo. App. 269; Whitehead *v.* Root, 3 Met. 587; Stanton *v.* Small, 3 Sandf. 230; McIlvaine *v.* Edgerton, 2 Robt. 422; Cole *v.* Milmine, 88 Ill. 349; Logan *v.* Musick, 81 Ib. 415; Wolcott *v.* Heath, 78 Ib. 433; Brown *v.* Meyers, 20 Gratt. 296; Porter *v.* Viets, 1 Biss. 177; ex parte Young, 6 Ib. 53; Clarke *v.* Foss, 7 Ib. 540; Hibblewhite *v.* McMornie, 5 M. & W. 462. And as to stock operations: Hatch *v.* Douglass, 48 Conn. 116; Cassard *v.* Hindman, 1 Bosw. 207; Bigelow *v.* Benedict, 70 N. Y. 202; Morris *v.* Tunbridge, 83 Ib. 92; Smith *v.* Bouvier, 70 Pa. St. 325; Grizewood *v.* Blaine, 11 C. B. 526; Mortimer *v.* Morine, 6 M. & W. 58; Thacker *v.* Hardy, L. R. 4 Q. B. D. 285.

[2] Union Nat. Bank *v.* Carr, 15 Fed. Rep. 438; s. c. 5 McCrary, 71.

the very transaction itself, and determine from facts and circumstances *dehors* the option ticket, what was the original contract between the broker and customer, and the character of the deal in which the agreement is made that there shall be no delivery. If the transaction is only a speculation in prices by all the parties interested, it is of no importance that the form assumed for the transaction is in the form of a seller's option, valid everywhere.[1] In order, however, to have the effect stated of rendering the contract void, and to defeat the recovery of the broker from his customer, it is essential that the illegal purpose of merely wagering on prices should be mutual with both broker and customer, and the third persons with whom such deals were made on the Exchange. If such valid contracts for the sale or purchase of any commodity are entered by one of the parties in good faith with the intention to perform the same, in accordance with the rules and usages of the Exchange in which the deal is made, they are sustained. The broker who, under such circumstances, has paid a loss caused

[1] Cobb *v.* Prell, 15 Fed. Rep. 774; Bartlett *v.* Smith, 13 Ib. 263; Melchert *v.* American Union Tel. Co. 11 Ib. 193; Third Nat. Bank *v.* Harrison, 10 Ib. 243; Gregory *v.* Watowa, 57 Iowa, 711; Union National Bank *v.* Carr, 15 Fed. Rep. 438; Pickering *v.* Case, 79 Ill. 238; Lyon *v.* Culbertson, 83 Ill. 33; Corbett *v.* Underwood, Ib. 324; Calderwood *v.* McCrea, 11 Bradw. 543; Tenny *v.* Foote, 4 Ib. 591; s. c. 95 Ill. 109; Gregory *v.* Wendell, 39 Mich. 337; s. c. 40 Ib. 432; Sawyer *v.* Taggart, 14 Bush, 727; May *v.* Hoagland, 9 Bush, 172; Rudolph *v.* Winters, 7 Neb. 126; Wilhelm *v.* Carr, 80 N. C. 294; Rumsey *v.* Berry, 65 Me. 570; Williams *v.* Tedeman, 6 Mo. App. 269; Waterman *v.* Buckland, 1 Ib. 45; Teekes *v.* Soloman, 11 Hun, 473; Cooke *v.* Davis, 53 N. Y. 318; Cameron *v.* Durkheim, 55 Ib. 425; Peabody *v.* Speyers, 56 Ib. 230; Barnard *v.* Backhaus, 52 Wis. 593; Everingham *v.* Meighan, 55 Ib. 354. And in cases of stocks: Dickson *v.* Thomas, 93 Pa. St. 278; Brua's App. 55 Pa. St. 299; North *v.* Phillips, 89 Ib. 250; Matton *v.* Sheen, 75 Ib. 166; Swartz's App. 3 Brewst. 131; Kirkpatrick *v.* Bonsall, 72 Pa. St. 155; Maxten *v.* Aheen, 75 Ib. 166; Farcira *v.* Gabell, 89 Ib. 89; Yerkes *v.* Salomon, 18 Hun, 471; Cassard *v.* Hinman, 1 Bosw. 20; Bigelow v. Benedict, 70 N. Y. 202; Sampson *v.* Shaw, 101 Mass. 145; Buck *v.* Albee, 26 Vt. 184; Grizewood *v.* Blaine, 11 C. B. 73; Fisher *v.* Bridge, 3 El. & Bl. 642; ex parte Marnham, 2 DeG. F. & J. 634.

by a change in the market value, upon his customer's request, may recover the amount of such advance from the customer, although it may have been the intention of the latter simply to speculate in prices, and to settle all trades by paying or receiving differences.[1]

Contracts to sell or purchase stocks without any intention to deliver or receive, are gaming contracts, and utterly void.[2] No recovery was allowed, the transaction being regarded as a gaming device, where a customer directed a stockbroker to sell a number of certain shares short on his account, although no certificates were delivered to the broker. The contract between the parties was that there should be no actual delivery of the stock, but that the customer was to protect the broker from loss if the market value of the stock advanced, and to receive any difference in value from the broker if it declined. The broker was at liberty to make an actual delivery of the stock, which was in fact done, with stock borrowed for that purpose by the broker. The stock rose in value, and losses resulted which the broker paid, and then sued the customer to recover the amount.[3] In another action, a mere bet that certain stocks would sell within a certain sum in so many days, with no intention by either party to receive or deliver the stocks, the promissory notes made by the customer to the broker and delivered as margins upon the deal, were unenforceable in the hands of the broker, or of any indorsee not a holder for value without notice.[4]

[1] Rountree *v.* Smith, 108 U. S. 269; Pixley *v.* Boynton, 79 Ill. 353; Clarke *v.* Foss, 7 Biss. 540; Lehman *v.* Strassberger, 2 Woods, 559; Wilhelm *v.* Carr, 80 N.C. 294; Sawyer *v.* Taggart, 14 Bush, 727; May *v.* Hoagland, 9 Ib. 172. The fact that some of the parties with whom the stockbroker dealt were actual buyers and sellers, and did not intend to gamble, was considered insufficient to vary or change the illegal character of a wagering contract in stocks, in Farreira *v.* Gabell, 89 Pa. St. 89.

[2] Brua's App. 55 Pa.St. 294; North *v.* Phillips, 89 Ib. 250; Bigelow *v.* Benedict, 70 N. Y. 202; Buck *v.* Albee, 26 Vt. 184; Grizewood *v.* Blaine, 11 C. B. 73.

[3] Dickson *v.* Thomas, 93 Pa. St. 278.

[4] Brua's App. 55 Pa. St. 294.

§ 350. THE VALIDITY OF OPTION CONTRACTS, AS SHOWN BY EVIDENCE.—The intention of the parties to such option contracts, notwithstanding the agreements appear in written instruments, will be allowed to be proved, and are of controlling importance as to the character of such contract, whether valid or not.[1] Where parties have been in the habit of dealing in options illegal in character, the broker, seeking to recover damages in an action at law for breach of contract by his customer, upon deals alleged by the customer to be of like character, is required to show by a preponderance of evidence that the later transactions involved in the suit were founded upon valid option contracts.[2] The duty of the court in such cases is "to scrutinize very closely these time contracts, and if the contracts are such as to throw doubt upon the question of the intention of the parties, it is not too much to require a party claiming rights under such a contract to show affirmatively that it was made with actual view to delivery and receipt of the grain."[3] An intention to violate the law prohibiting gaming contracts is not presumed where brokers employed to trade for a customer testified that they had no intention to make and did not make any illegal option contracts for their customer, the other parties to the deal not being produced at the trial, nor their depositions read. The contracts actually made were the valid "seller's options," the common contract, and in some instances the commodity purchased was actually delivered. The fact alleged that a very large proportion of the option contracts on the Exchange where the deals were made, are settled by pay-

[1] Cassard *v.* Hinman, 1 Bosw. 207; Yerkes *v.* Salomon, 18 Hun, 471; Bigelow *v.* Benedict, 70 N. Y. 202; Colderwood *v.* McCrea, 11 Bradw. 543; Dolby *v.* Spaids, 8 Ib. 549; Farreira *v.* Gabell, 89 Pa. St. 89; Kirkpatrick *v.* Bonsell, 72 Ib. 155; in re Morgan, 2 DeG. F. & J. 634; Bartlett *v.* Smith, 13 Fed. Rep. 263; Union Nat. Bank *v.* Carr, 15 Ib. 438.

[2] Cobb *v.* Prell, 15 Fed. Rep. 774.

[3] Barnard *v.* Backhaus, 52 Wis. 593. Cited with approval by McCrary, J., in Cobb *v.* Prell, 15 Fed. Rep. 774.

ment of differences, the number being so large in proportion to contracts in which actual delivery is mutually intended as to raise an inference that the trades in question were of that character, is not of itself sufficient, in the absence of all other evidence, to create a presumption that the deals made for the customer were for the payments of differences only.[1]

Evidence may be introduced tending to sustain the claim of brokers operating on an Exchange, in an action for advances paid on account of losses and services rendered, that they were employed as brokers or commission merchants to purchase or to sell wheat for future delivery, and that in all of the contracts entered into by them with other parties on the Exchange the business was conducted in their own name, but for defendant's benefit and on his account, and in every instance an actual delivery of wheat was intended by them and the other parties to the contract.[2] The same evidence was given by a number of stockbrokers on the New York Stock Exchange, establishing bona fide purchases and sales in a "short" stock option, where an action of assumpsit was brought by the broker to recover moneys paid out and commissions, and the defense was that the speculation was a mere stock jobbing transaction, to be settled upon differences only.[3] In another case, where an attempt was made to set up illegality in the contracts between a broker and his customer, as a defense to an action to enforce a guaranty of a negotiable promissory note, given in settlement of the account, with other like notes made by the customer, and received, before maturity, by a bona fide pledgee for value, advanced upon the discount of a note of the broker, with the other note executed by a third person and guaranteed by the customer, indorsed as collateral security. It was shown in evidence that the

[1] Rountree *v.* Smith, 108 U. S. 269.

[2] Bartlett *v.* Smith, 13 Fed. Rep. 263.

[3] Smith *v.* Bouvier, 70 Pa. St. 325.

options dealt in were valid, and that the broker, at the time of the first engagement, explained to the customer that by reason of his having many buyers and sellers as customers, he might arrange so as to avoid delivery upon his deals, was without effect upon the character of the valid deals actually made, and formed no defense to the guaranty in the hands of a pledgee for value, without notice.[1]

§ 351. Evidence of intention, upon Action on contract by Broker.—Evidence to establish the intention of parties to settle upon differences only, in cases where the broker seeks to recover moneys paid by him for losses, by an action upon his contract with the customer is properly given by the parties. Where such agreement has not assumed a written form, the intention of the parties may be learned from their conversations and correspondence. If it be established by evidence that the mutual intentions of both parties were that no deliveries of the commodities bought or sold for the customer should be made, and that all deals should be settled upon the payment or receipt of differences merely, no recovery by the broker is permitted for a breach of such contract, in the event of losses paid by him, the contract itself being illegal and void.[2] The illegal character of such deals, established by evidence, where the parties, both broker and customer, join in the intention to deal in nothing but speculations on prices, will defeat any claim of the broker against the customer founded upon losses paid in such transactions, although he shows by the testimony of other brokers upon the Exchange, that some of the deals made were with actual sellers and buyers, not intending to gamble.[3]

The rule applied to the broker, defeating his recovery

[1] Jackson *v.* Foote, 11 Fed. Rep. 37.

[2] Cobb *v.* Prell, 15 Fed. Rep. 774 (McCrary, J.); Melchert *v.* American Un. Tel. Co. 11 Ib. 193; Gregory *v.* Wendell, 39 Mich. 337; Barnard *v.* Backhaus, 52 Wis. 593; Pickering *v.* Cease, 79 Ill. 328; Lyon *v.* Culbertson, 83 Ill. 33.

[3] Fariera *v.* Gabell, 89 Pa. St. 89.

upon mere gaming speculations, is enforced against the customer, where, after trading upon differences, through a broker, upon margins and securities deposited, until the same are exhausted, he seeks to recover the same, or the value thereof, from the broker. Neither party to illegal and void gaming contracts will be aided, by a court of law or of equity.[1]

§ 352. THE BROKER'S OPTION CONTRACT VALID, UPON PURCHASE OF STOCK.—Option contracts, although the customer's intention to settle by paying or receiving differences be known to the broker, are supported where the broker actually purchases the agreed commodity upon the contract. The fact that the broker accepted the order on the implied terms and understanding that he would not be called upon by the customer to deliver the stocks, nor that the customer would pay for the same, but that the intention was that the stocks should be resold by the broker for the customer before the day of payment arrived, and that the latter should either pay or receive on the re-sale, the difference, after allowing the broker's charges, is not sufficient to defeat the claim of the broker.[2] The like rule was applied in a case where an order was given to a stockbroker: "I want to buy say 100 shares of Union Pacific on margin; will you take $1,000 first mortgage bond N. Y. & O. R. R., and do it?" The stock was bought by the broker, and subsequently sold at a profit, and other speculative stock transactions followed, resulting in losses exceeding the value of the collateral. The broker had made actual purchases of stock, and was ready to transfer the same to the customer on payment of the balance of the purchase money, after crediting the sum realized from the sale of the collateral. As the transactions were made upon valid options, and not for the payment of differences merely, the customer was

[1] Gregory *v.* Wendell, 39 Mich. 337; Buck *v.* Albee, 26 Vt. 184.

[2] Ashton *v.* Daken, 4 Hurls. & N. 867.

required to pay the losses.[1] The following transaction, an operation on the London Stock Exchange, is supported, as not coming within the definition of a mere wager. A member of the Stock Exchange loans another member, on a deposit of shares, a sum of money equal to their market value, such sum to be repaid on the next settling day, and if not paid, then according to the rules of the Stock Exchange, the holder is entitled to retain the shares at the market price of that day, the difference in value to be paid by the lender to the borrower, or vice versa, as the shares may rise or fall in value. If the loan is not paid, the transaction is carried over to the next settling day, upon the then market value, the borrower paying differences. This operation was in one case several times repeated, and at last the pledgor became insolvent, and the pledgee took the shares which were worth less than the amount due, and was allowed to prove for the balance of the loan in bankruptcy proceedings.[2]

A transaction was sustained as valid, where a customer employed a broker to sell stock at a certain price, to be delivered on a particular day, and the stock was sold as ordered. At the time of delivery, prices having risen, the broker was obliged to borrow stocks, the customer having none, and afterwards, under instructions, bought stocks at a yet higher price, to replace those borrowed. The customer was required to pay the difference, as a deal, although a speculation in stocks, when founded on a sale and purchase thereof, is not an invalid contract.[3] An agreement for the sale and transfer, at a future day and for a specific price, of a given number of shares of stock which the vendor then actually had, and of which an actual transfer was intended, is not a stock-jobbing or wagering contract.[4] A vendor of stock, of which he was not at the time of sale possessed, but which

[1] Hatch *v.* Douglass, 48 Conn. 116.

[2] Ex parte Phillips, 2 DeG. F. & J. 34. The rule is applied to a sale of stocks where differences were paid on several successive settling days. Ex parte Morgan, Ib. 37.

[3] Smith *v.* Bouvier, 70 Pa. St. 325.

[4] Noyes *v.* Spaulding, 27 Vt. 40.

he afterwards bought and caused to be transferred to the vendee, is entitled to an action for the price.[1]

§ 353. Other option Contracts held valid.—An option contract, whereby A, for a valuable consideration, agreed to receive from B at any time within six months from the date of the contract $2,500 United States gold coin, and to pay therefor in good current funds at the rate of $1.95 in currency for every $1.00 in coin, the contract expressly declaring that B did not contract to deliver the coin, but to pay the consideration for the privilege of delivering it or not at his option, is a valid option contract with no inherent vice therein, under the general rule that a vendor of commodities who expects to acquire or produce them in time for a future delivery, and is not willing to enter into an absolute contract to deliver, and yet is anxious to create a market for them, may bargain for an option, which while relieving him from liability, permits him to make a sale if he is able to deliver.[2] A "call" was sold, for a consideration, the seller agreeing to deliver at any time within six months, five thousand barrels of oil. The contract was: "If this oil is called for, this call becomes a contract; ten days' notice shall be given, and the undersigned, or his assigns, agree to receive and pay for the same at 10½ cents per gallon." While evidence, with other facts, of the intentions of the parties, either to gamble or not, the contract on its face was not an illegal deal.[3]

§ 354. The Broker's option deals on Boards of Trade.—The option deals on Boards of Trade are generally the usual contracts known as "seller's option," by which the vendor has a choice as to the time of delivery of

[1] Mortimer *v.* McCullan, 7 Mels. & W. 20.

[2] Bigelow *v.* Benedict, 70 N. Y. 202; Disborough *v.* Neilson, 3 Johns. Cas. 81; Stanton *v.* Small, 3 Sandf. 240; Railroad Company *v.* Dane, 43 N. Y. 240; Brown *v.* Hall, 5 Lans. 180.

[3] Kirkpatrick *v.* Bonsall, 72 Pa. St. 155.

the goods sold being the term during which such option runs, but is bound to deliver at the expiration of the time. The delivery by the seller is provided for by the terms of the contract, and by the rules and regulations of the several Boards, and, is, unless settlement be otherwise made, required, under penalty of discipline and possibly expulsion from the Exchange. The deal, however, may be closed at any time during the option by a bona fide settlement, without delivery, or by an arrangement with other firms by a process known as "ringing out," or a kind of clearing house, by which several trades are settled at once. Such arrangements, however, are only matters of convenience. Clearing houses, under the management of such Boards, performing the same duties as the clearing-house of the New York Stock Exchange, are in operation.[1]

§ 355. THE OPTIONS KNOWN AS "PUTS," "CALLS," "STRADDLES," AND "SHAVES."—The option called a "put" is a privilege given for a consideration of delivering, or not delivering, as the seller may elect, of a quantity of grain, or stocks, or other property, within a certain time, at a specified price. The party selling the privilege agrees that if delivery be made within the specific time he will pay for the property at the price named, or the differences, otherwise the seller of the privilege pockets the money paid therefor. A "call" is the opposite of a "put," the privilege being to call or not to call for delivery at the price agreed upon.[2]

[1] Gilbert *v.* Guager, 8 Biss. 214; Clark *v.* Foss, 7 Ib. 581. The seller's option contract is as follows:

"[Grain Contract.]

CHICAGO, ..., 188..—We have this day sold to..... bushels, No...., in store, at..... per bushel, to be delivered at seller's option during the month of..... 188.., in lots of 5,000 bushels each. This contract is subject in all respects to the rules and regulations of the Board of Trade of the city of Chicago. ————"

The buyer's contract given to the seller is the same, except in the use of the word "bought" in place of "sold."

[2] Ex parte Young, 6 Biss. 53; in re Green, 7 Ib. 338; in re Chandler,

A "straddle" is an option which includes the double privilege of a "put" and "call," and secures to the holder the right to demand of the seller at a certain price within a certain time a certain number of shares of specified stock or other property, or to require him to take at the same price within the same time the same shares of stock or other commodity. The time for which such double option shall continue is a matter of contract.[1] The value of a "straddle" as of a "put" or "call" depends upon the fluctuations of the stock or other property selected. The wider the range of these fluctuations up or down the greater the amount which may be realized. The longer the option continues, the greater the chance of such fluctuations.[2] A "shave" is a contract of a broker, upon consideration, to hold and carry stock in his customer's name for thirty, or sixty, or any other number of days, as the case may be, in order that the customer may have the advantage of any rise in price that may happen in the meantime, the understanding being that he is also to make good any fall in price. In neither case, is it intended by the parties that there shall be a delivery of the

13 Am. L. R. (N. S.) 310. The "put" contract on grain is as follows:

"CHICAGO,....., 188...

Received of A $.. in consideration of which we give him, or the holder of this contract, the privilege of delivering to us or not, prior to three o'clock P. M. of ..... 188.., by notification or delivery, ...bushels No..... regular receipts, at .... cents per bushel, in store, and, if delivered, we agree to receive and pay for the same at the above price. B."

The word "options" in the Illinois statute against gambling has been held to mean "a mere choice, right, or privilege of selling or buying, and it is the contracting for such choice, right, or privilege of selling or buying at a future time any commodity the statute was intended to prohibit as contra-distinguished from an actual sale or purchase, with the intention of delivering or accepting the commodity specified." Tenny *v.* Foote, 4 Bradw. 594; aff. 95 Ill. 109.

[1] Harris *v.* Tunbridge, 83 N Y. 92; Story *v.* Salomon, 71 Ib. 420; Yerkes *v.* Salomon, 18 Hun, 471.

[2] Ex parte Young, 6 Biss. 53; in re Chandler, 13 Am. L. R. N. S. 310; Harris *v.* Tunbridge, 83 N. Y. 92.

stock.[1] The option deals described as "puts" and "calls," have been declared illegal,[2] and also the "shave."[3] In the case of the "straddle," the question of legality depends upon the evidence, as in cases of stock speculation, it is not considered as a wagering contract, nor is any illegal intent presumed. Where losses resulted from the wrongful neglect of a broker operating a "straddle," the contract was held so far valid that the customer, a woman, was allowed damages for the tort.[4]

[1] North *v.* Phillips, 89 Pa. St. 250.

[2] Pixley *v.* Boynton, 79 Ill. 533; Pickering *v.* Cease, Ib. 327; in re Chandler, supra; ex parte Young, 6 Biss. 53; Rudolph *v.* Winters, 7 Neb. 126.

[3] North *v.* Phillips, 89 Pa. St. 250.

[4] Harris *v.* Tunbridge, 83 N.Y. 92; Story *v.* Salomon, 71 Ib. 420.

CHAPTER XXXVI.

THE BROKER'S SUIT AGAINST CUSTOMER.

§356. The broker's recovery against his customer.
357. Payment by broker of differences, upon customer's request.
358. The broker's recovery on bills and notes given for differences.
359. No recovery allowed broker upon illegal transactions.
360. Other limitations of the broker's recovery.
361. No recovery under illegal contracts to "corner."
362. Relief to the customer, when given.

§ 356. THE BROKER'S RECOVERY AGAINST HIS CUSTOMER.—The recovery of the broker against his customer, where upon a failure to put up further margins, or upon an order to close the deal, the trade is settled at a loss, which the broker pays, at his customer's request, express or implied, is sustained where the contracts between the parties, and those made on the Exchange, are valid. It is also well settled that the customer is liable to the broker in an action for money paid and services performed, although the deals were intended by the customer to be mere wagers or bets on the rise or fall of prices, the actual trades made having been upon valid option contracts, or the property actually bought or sold, for the customer's account, in the name of the broker. The liability of the customer to pay in such action is not affected even where the contracts made upon the Exchange, while valid upon their face, are intended by the parties to be settled by the payment of differences. The action is independent of the contracts made upon the Exchange, and any taint of immorality which might attach if the action were upon mere wagering contracts, forms no defense to a suit by the broker for moneys paid upon re-

quest and services performed. The customer is not allowed to gamble at the expense of the broker, who does the work, and generally advances ninety per cent. of the money required to purchase the stocks, or pays the losses upon the closing out of the deal in transactions in other commodities.[1] The rule is also applied where there has been a settlement between the parties upon the speculative deals made by the broker for his customer, in which losses have been made, and the customer has executed promis-

[1] Rountree *v.* Smith, 108 U. S. Rep. 269; Armstrong *v.* Toler, 11 Wheat. 274; Gilbert *v.* Guager, 8 Biss. 214, 217; Clark *v.* Foss, 7 Ib. 551; Third National Bank *v.* Harrison, 10 Fed. Rep. 243. Tinsley's case, *n.*; Bartlett *v.* Smith, 13 Ib. 263; Lehman *v.* Strassberger, 2 Woods, 554; Owen *v.* Davis, 1 Bail. (S C.) 315; Rumsey *v.* Berry, 65 Me. 570; Warren *v.* Hewitt, 45 Geo. 501; Smith *v.* Bouvier, 70 Pa. St. 325; Durant *v.* Bart, 98 Mass. 161; Thacker *v.* Hardy, L. R. 4 Q. B. D. 685. In Tinsley's case, supra, aff. Bank *v.* Tinsley, 11 Mo. App. 259, where a broker recovered money paid for losses on invalid option contracts, at the customer's request, the court (Thayer, J.) say: "There are cases arising between factors and brokers and their principals which the courts have apparently treated as though the action was between the principals to the illegal transaction. But the different relations existing between the agent and his principal, in actions by the former to recover monies expended for his principal in settlement of losses on wagering contracts, was apparently not called to the attention of the court." Citing Gregory *v.* Wendell, 39 Mich. 337; Williams *v.* Tiedeman, 6 Mo. App. 269. In Smith *v.* Bouvier, supra, an action of assumpsit for losses paid on speculative stock transactions, the court (Thompson, C. J.) say: "It was sought to instruct the jury that all purchases of stocks, with a view to re-sale and make a profit on their rise, or contracts to furnish stocks on time, should be declared gambling transactions and unlawful, not only between the buyer and seller, but as to the brokers or agents through whom the sales and purchases had been made. This would make a great inroad into what has for an indefinite period been regarded as a legitimate business, and would either destroy it altogether, or, continued, put the brokers at the mercy of those for whom they transact such business. Let it be understood that a broker has no power to recover either for advances or commissions, however honestly he may have dealt, and there will be found enough persons whose easy consciences would throw the loss upon the shoulders of those who advanced the money and earned commissions in their service. It would be a very palpable wrong to the brokers who are licensed to do such business, if such were held to be the law."

sory notes or indorsed over other commercial paper executed by third parties. It is no defense as against such paper that the contracts made on the Exchange were intended to be settled by the payment of differences, although valid on their face. In such case, the promise is express to pay the money advanced and the commissions earned; in the other, it is implied, as every customer is bound by the rules of the Exchange in which he employs a broker to deal, and failure of the broker to pay such losses may result in suspension and possibly expulsion.[1]

§ 357. Payment by Broker of differences, upon Customer's request.—Where, after a broker or commission merchant has made for a customer a valid contract for the purchase or sale of stocks or grain, or other commodities, and by reason of the adverse condition of the markets, he is directed by his customer to settle with the buyers or sellers before the maturity of the contract, and by reason thereof pays the differences, exceeding in amount the collaterals and margins deposited by the customer, an action accrues to the broker against his customer for the money paid and and his commissions.[2] The right of the broker to collect money paid at his request, and for services rendered, was approved in a case, where a customer employed a broker to sell ten thousand bushels of wheat at a certain price to be delivered at a certain time, depositing $700 as a margin, and contracts for its sale were accordingly made. The broker knew at the time the customer had no wheat. The market price of wheat continued to rise, until the transaction finally resulted in a loss of about $3,000, which was paid by the broker. He was allowed to recover the balance of the debt from the customer, after crediting the collateral fund.[3] An

[1] Jackson *v.* Foote, 12 Fed. Rep. 37; Clark *v.* Foss, 7 Biss. 540; Lehmann *v.* Strassberger, 2 Woods, 554; Third Nat. Bank *v.* Harrison, 10 Fed. Rep. 243.

[2] Gilbert *v.* Guager, 8 Biss. 214.

[3] Rumsey *v.* Berry, 65 Me. 570.

action of assumpsit was supported, when brought by brokers against a customer for money laid out and expended in the purchase and sale of stocks, the transaction being a speculation based upon bona fide sales and purchases of stocks by the brokers.

The Court of Queen's Bench of England, in a late case,[2] sustained the recovery of a broker, as being founded upon valid stock options, where a customer engaged a broker to speculate for him on the London Stock Exchange, knowing that, by the rules of that body, the broker would have to enter into valid contracts to buy and sell stocks, and incur the risk of having to accept and pay for or to deliver the stocks covered by his speculations. The broker knew that the customer was not of sufficient financial ability to pay for or deliver the stocks proposed to be sold or bought, and did not expect or intend to accept delivery nor to deliver stocks sold on his account. The intention of the customer was that the broker should so arrange the deals, that nothing but differences should be paid by or payable to him. The broker made actual sales and purchases, according to the rules of the Exchange. Upon default of the customer, the broker was obliged to pay a large sum for losses; and in an action against the customer, was allowed to recover the money advanced and commissions earned. The recovery of a broker, who has, upon the settlement of voidable contracts, for stocks made upon the Exchange, for the benefit of a customer, paid sums due, upon request, although for differences only, has always been supported by the English courts.[3]

[1] Smith *v.* Bouvier, 70 Pa. St. 325.

[2] Thacker *v.* Hardy, L. R. 4 Q. B. D. 685. The like result was reached, upon similar facts, in grain speculations, in Jackson *v.* Foote, 12 Fed. Rep. 37.

[3] Rosewarner *v.* Billings, 15 C. B. N. S. 316; Pidgeon *v.* Burslem, 3 Exch. 465; Knight *v.* Cambers, 15 C. B. 563; Olds *v.* Harrison, 10 Ex. 572; Farmer *v.* Russell, 1 Bos. & P. 296; Jessopp *v.* Lutwyche, 10 Ex. 614; Falkney *v.* Reynous, 4 Burr. 2069; Tenant *v.* Elliott, 1 B.& P. 3; Petrie *v.* Hannaway, 3 Term, 418.

§ 358. THE BROKER'S RECOVERY UPON NOTES GIVEN FOR DIFFERENCES.—A broker, who has paid losses at his customer's request, upon valid option contracts for the sale of commodities for future delivery, upon an agreement or understanding with the customer that the trades should be settled by the payment of differences only, is entitled to enforce the payment of promissory notes given by the customer in settlement thereof, as the liability of the customer upon the notes is supported by a good consideration in money advanced and services performed, independently of any prior contract between the parties which may have been tainted with illegality.[1] Promissory notes, secured by mortgage, executed by a customer to secure the payment of moneys advanced by the broker or commission merchant to pay losses resulting from transactions in option deals illegal in their character, are enforced as not necessarily contaminated by the vice of the original contracts as made upon the Exchange.[2] Nor will a statutory provision making void notes executed in consideration of "money won at any game or gambling device," apply to a note given upon a wager on the future price of grain, although there was no intention by either party to make delivery.[3] A guaranty of the payment of a promissory note of a third person given in settlement of accounts by a customer to a broker, where the option contracts involved might have been illegal at common law, but did not come within the definition of gaming options in a criminal code, will not be defeated by this equity in the hands of a bona fide pledgee for value receiving them for an advance to the brokers, and seeking to enforce such guaranty, upon default in the payment of the principal claim.[4]

§ 359. NO RECOVERY ALLOWED THE BROKER FOR ADVANCES FOR ILLEGAL TRADES.—The aid of courts is not

[1] Lehmann *v.* Strassberger, 2 Woods, 554.

[2] Clark *v.* Foss, 7 Biss. 540.

[3] Third National Bank *v.* Harrison, 10 Fed. Rep. 243.

[4] Jackson *v.* Foote, 12 Fed. Rep. 37.

given to brokers or commission merchants, to recover losses paid or commissions, where such broker or commission merchant has furnished funds under an agreement, expressed or implied, to enable the customer to deal in mere speculations on future prices, or illegal options. Promissory notes given in settlement of such advances cannot be enforced by the parties, and where they are rendered void by statute, are worthless even in the hands of a bona fide holder for value. Such speculations, without any intention of either party to deliver, are mere bets or wagers, the person advancing the stake having no claim to the aid of legal process to recover his money. Being obliged to rely upon illegal and void contracts to establish his claim, no aid is given the broker.[1] An indorsement of negotiable paper made as collateral security by a customer to secure money advanced by a broker in order to prosecute the illegal ventures of the customer, and to indemnify the broker from loss by reason of the ventures being made in his name and not that of the customer, is void, and no recovery can be obtained thereon.[2] The transfer of commercial paper by a customer to a broker, under such circumstances, although ostensibly as margins to protect the broker in his purchases, is but putting up a stake in a game of chance. No greater rights are acquired by the broker, or by parties charged with knowledge, than under an indorsement tainted with forgery. The ownership of such paper remains in the customer, and upon notice to the drawee of a bill of exchange or maker of a promissory note, given as margins upon gambling options, not to pay

[1] Armstrong *v.* Toller, 11 Wheat. 258; in re Green's case, 7 Biss 338; s. c. 15 N. B. R. 198; Third National Bank *v.* Harrison, 10 Fed. Rep. 243; Bartlett *v.* Smith, 13 Fed. Rep. 263; Tenny *v.* Foote, 4 Bradw. 594; s. c. 95 Ill. 109; Henderson *v.* Palmer, 71 Ill 579; Lyon *v.* Culbertson, 83 Ib. 33; Pickering *v.* Case, 79 Ib. 328; White *v.* Bass, 3 Cush. 148; Ruckman *v.* Ryan, 3 Denio, 340; Kirkpatrick *v.* Bonsall, 72 Pa. St. 155; Fareira *v.* Gabell, 89 Ib. 89; Dickson *v.* Thomas, 93 Ib. 278; Hooker *v.* Knab, 26 Wis. 211; Cannon *v.* Bryce, 3 B. & Ald. 179; McKinnell *v.* Robinson, 3 M. & W. 434.

[2] Tinsley's case, 10 Fed. Rep. 243, 245, *n.*; aff. 11 Mo. App. 259.

the same, the drawee or maker will be charged with the amount of the paper if afterwards they pay the same.[1]

The like rules apply to guaranties of commercial paper made by a customer and transferred to brokers in settlement of illegal gambling speculations upon Exchanges. All bills and notes given in connection with mere speculations in prices or illegal options, are made void by statute, and a guaranty indorsed thereon, is unenforcible even in the hands of a holder for value, without notice.[2] Nor will a compromise between the parties to such void contracts be supported, being tainted with the illegality of the prior transactions. No compromise is possible on the question of validity.[3]

§ 360.—THE LIKE RULES AS TO STOCK GAMBLING DEALS. —The like rules are applied in cases where brokers dealing in gambling transactions in stocks seek to recover money paid in settlement of losses. No recovery is permitted.[4] Knowledge by an indorsee of a bill of exchange that the bill was drawn by a broker and accepted by the customer, for differences arising in several stock-jobbing transactions, will defeat any recovery as against the acceptor. Chargeable with knowledge of the facts, an indorsee although for value can acquire no greater rights than the broker from whom the bill was received.[5] Where such paper given as margins upon stock gambling options, is transferred after maturity, as collateral security for a pre-existing debt, in states where the restricted rule prevails, the pledgee is not a holder for

[1] Bank *v.* Spaids, 8 Bradw. 493; Dickson *v.* Thomas, 93 Pa. St. 278; North *v.* Phillips, 89 Ib. 250; Steers *v.* Lashley, 6 Term, 61; Barnard *v.* Backhaus, 52 Wis. 593; Tenny *v.* Foote, 4 Bradw. 594; s. c. 95 Ill. 109; Farriera *v.* Gabell, 89 Pa. St. 89.

[2] Tenny *v.* Foote, 4 Bradw. 594; s. c. 95 Ill. 109.

[3] Everingham *v.* Meigham, 55 Wis. 354; Melchoir *v.* McCarty, 31 Wis. 252.

[4] Dickson *v.* Thomas, 93 Pa. St. 278; North *v.* Philips, 89 Ib. 250; Brua's App. 55 Ib. 299.

[5] Steers *v.* Lashley, 6 Term, 61.

value, in the usual course of business, but is subject to antecedent equities.[1]

§ 361.—No recovery under Illegal contracts to "Corner."—Agreements to "corner" a market or to stifle competition, being illegal and void, as against public policy, courts of equity refuse to aid parties engaged therein to recover money advanced in connection therewith where they have been executed or to compel a division of the proceeds between the parties. Persons who have participated in such contracts do not come into court with the clean hands necessary when seeking equitable relief. The rule was enforced where all the grain dealers of a town entered into a secret general partnership, providing that each separate firm should conduct their own warehouse as before as if there were no partnership, keep their own books, pay their own expenses, ship their own grain, and furnish their own funds to do business with, and at the end of each month, each individual firm's accounts was to be balanced, and profits or losses stated, and the amount remaining divided according the number of shares of each firm in the partnership. A bill for an accounting and division of the profits brought by one of the parties, was dismissed.[2] Equity will not aid parties to enforce an illegal contract, or a contract growing out of an illegal act, but leaves the parties in the situation where they have placed themselves.[3] Upon an agreement to "corner" the market upon a certain stock, a third person advanced funds to aid the purpose. Afterwards, he sought to recover the money back, but was given no relief as to the amount actually expended, although allowed to recover the funds still in the hands of the parties to the illegal contract.[4] And it is no defense to a negotiable promissory note, in the hands of a broker, given on

[1] Brua's App. 55 Pa. St. 299.

[2] Craft *v.* McConoughy, 79 Ill. 349.

[3] Buck *v.* Albee, 26 Vt. 184.

[4] Sampson *v.* Shaw, 101 Mass. 145; Ball *v.* Gilbert, 12 Met. 397.

account of purchases authorized by the customer, that the latter secretly intended to create a "corner" in the article bought, the broker not being informed of his illegal intention.[1]

§ 362.—Relief to the Customer, when given.—The presumption arises, in the absence of direct testimony, where a minor of limited means embarks in stock speculations to a large extent, putting up margins, that he does not intend to receive or deliver the stocks bought or sold on his behalf. Failure in these essentials show that the deals entered into were wagering contracts merely, contrary to the policy of the law, and therefore void *ab initio*. The minor was allowed, his entire margins having been lost, to recover the sums advanced by him to the brokers.[2] A payment of margins may be recovered back and the contract repudiated in a case where the customer purchasing alone acted in good faith, the vendor receiving the margins without obtaining the goods for delivery.[3]

[1] Wright *v.* Crabbs, 78 Ind. 487.
[2] Ruchizky *v.* DeHaven, 97 Pa. St. 202.
[3] Gregory *v.* Wendell, 39 Mich. 337.

CHAPTER XXXVII.

USAGES ON STOCK AND OTHER EXCHANGES.

§363. The usages and customs of brokers on stock exchanges.
364. Custom of stock broker to sell upon default without notice.
365. The usage as to notice of sale in New York.
366. The sale of stocks by brokers, under special contract.
367. The usage as to notice of sale on Boards of Trade.
368. The broker's usages, dealing with his customer's stock.
369. The broker's usages not to retain identical certificates or grain ceipts.
370. The broker's usages as to funds, charges, and interest.
371. The broker's usage as to "name" day.
372. Usages of brokers not binding upon customers.

§ 363.—The Usages of Brokers on Stock Exchanges. —The relations and contract of a broker and his customer, as to the extent the latter is bound by the customs and usages prevailing upon the Exchange where the proposed deals are to be made, are governed by the general principle that one who employs another to act for him at a particular market as a stock or grain exchange, is regarded as intending that his business shall be done according to the usages and customs of that place, whether the customer is in fact informed of such usages and customs or not. Such usages and customs are scrutinized closely, where they affect the interests of third parties. They are required to be valid, and reasonable, and such as not to change the intrinsic character of the contract between the parties.[1] Such usages and customs,

[1] Wheeler *v.* Newbould, 16 N. Y. 392; Evans *v.* Waln. 71 Pa. St. 69; Marye *v.* Strouse, 5 Fed. Rep. 486; Nichols *v.* Merry, L. R. 7 Ch. 733; s. c. L.R. 7 H. L. 530; Neilson *v.* James, L. R. 9 Q. B. D. 546; Robinson *v.* Mollett, L. R. 7 H. L. 802; Maxted *v.* Paine, L. R. 6 Ex. 132;

in order to be enforced as against the customer, must be so general in their operation as that he must be supposed to have contracted with reference thereto.[1] Nor will evidence of usage be permitted to vary the terms of a special contract between the parties, or to introduce new conditions therein, or to authorize the doing of acts in direct contravention of its provisions, although evidence may serve to interpret the language of the contract, or, where the meaning is equivocal or obscure, to ascertain its nature and extent.[2]

§ 364.—Custom of Brokers to Sell, on default, without notice.—The usage of stockbrokers, upon the fall in value of stocks purchased and carried by them for a customer, below a price sufficient fully to reimburse the broker, to sell the same, upon default, without notice, is valid. The broker carrying stocks upon margins, having advanced ninety per cent. of the purchase money, and holding the certificates and margins as collateral security, is entitled to sell such stocks at the Stock Exchange, without notice to the customer. The customer will also be liable in an action by the broker, for moneys paid and services rendered, at his request, for the deficiency, if any, arising at such sale.[3] The contract of the stockbroker and customer is regarded in Massachusetts, not as creating the relations of a pledgor and pledgee, but as a conditional agreement to deliver so many shares of stock at a certain time and the payment of so much money. Where stocks are bought by a stockbroker chiefly with his own funds, the customer simply putting up margins, and the market declines, and the customer defaults upon demand for more margin, it is a uniform

Coles *v.* Bristowe, L. R. 4 Ch. 5; Grissell *v.* Bristowe, L. R. 4 C. P. 36; Sutton *v.* Tatham, 10 Ad. & E. 27; Mitchell *v.* Newhall, 15 M. & W. 308.

[1] Harris *v.* Turnbridge, 83 N. Y. 92; Lyon *v.* Culbertson, 83 Ill. 324.

[2] Parsons *v.* Martin, 11 Gray, 111; Allen *v.* Dykers, 3 Hill, 593; s. c. 7 Ib. 497.

[3] Colket *v.* Ellis, 10 Phila. 375; Vanhorne *v.* Gilbough, 10 W. N. Cas. 347.

and well-established rule with the stockbrokers to sell the stocks so carried at their pleasure, without notice to the customer.[1] The rule is applied in favor of a consignee or commission merchant, who advances funds upon a shipment of grain or other property, to a large percentage of its value. Such consignee or commission merchant may, in the absence of any agreement, sell the grain or other property, at such time as he sees proper, to the extent and in payment of his advances.[2]

§ 365. THE USAGE AS TO NOTICE OF SALE IN NEW YORK.—In New York, a broker, purchasing stocks for a customer, upon the deposit of margins, and holding the same in his own name, as collateral security for his advances, is a pledgee. Applying to the parties the rules applicable to the relations of pledgor and pledgee, a usage of the Stock Exchange of New York by which the broker, upon failure of the customer to supply further margins, upon demand, might sell such stocks on the Exchange without notice of the time and place, was adjudged illegal. In the leading case of Markham *v.* Jaudon,[3] the Court of Appeals by Hunt, C. J., established the rule upon this subject, which has been followed in later cases. The offer to prove the existence of the custom as stated was "an offer (said the court) not to explain the meaning of particular terms, or to prove attending circumstances, to enable the court to construe the agreement, but to change the rights of the parties. By the law as I have interpreted it, the customer did not lose the title to his stock by any process less than a sale upon reasonable notice or by judicial

[1] Covell *v.* Loud, 135 Mass. 41 (Devens J.).

[2] Weed *v.* Adams, 37 Conn. 378; Howard *v.* Davis, 40 Mich. 546; Brown *v.* McGraw, 14 Pet. 479; Field *v.* Farrington, 10 Wall. 141; Mayfield *v.* Douglas, 1 Sandf. 360; Butterfield *v.* Stevens, 59 Iowa, 596.

[3] 41 N. Y. 235. Cited with approval in Stenton *v.* Jerome, 54 N. Y. 480; Baker *v.* Drake, 66 Ib. 518; Gruman *v.* Smith, 81 Ib. 25.

proceedings. The broker had no right to sell without notice. A practice or custom to do otherwise would have no more force than a custom to protest notes on the first day of grace, or a custom of brokers not to purchase the shares at all in a case like the present, but to content themselves with a memorandum or entry in their books of the contract made with their customer. Such practice in each case would be in hostility to the terms of the contract, an attempt to change its obligation, and would be void. The proof could not therefore be legally given. * * * It is said that the stocks which are the subject of speculation are fluctuating and uncertain in character; that to save the broker from loss prompt action is necessary, and that there is no time for notice to the dealer. It is said in the same connection that as the broker can make nothing by the rise of the stock, his advantage being limited to his regular interest and commissions, it is reasonable and must have been the understanding that he should have the power to protect himself against loss by an immediate sale without notice. I cannot assent to this argument. If there is such a necessity, the broker must secure himself by a special contract, giving him the right to sell without notice."

§ 366. The sale of Stocks by the Broker under special contract.—The rule announced in Markham *v.* Jaudon, as to the pledge relations of the broker and his customer, and the notice required before a valid sale of stock purchased by the broker for his customer could be made, is subject, as suggested in the leading case, to the limitation that the parties to such a transaction may provide by contract for any manner of disposing of the pledged stocks to satisfy the broker's claim, provided the terms thereof are not in contravention of a statute, nor against public policy, nor fraudulent.[1] A contract that "all trans-

[1] Baker *v.* Drake, 66 N. Y. 518; Stenton *v.* Jerome, 54 Ib. 480; Milliken *v.* Dehon, 27 Ib. 364; Wheeler *v.* Newbould, 16 Ib. 392.

actions" should be "in every way subject to the usages of your (the broker's) office," entitled the broker to show by evidence that the custom of his office was, upon failure of a customer to furnish sufficient margins, upon demand, to sell the stock at the Stock Exchange, without notice of the time and place of sale.[1] A sale of stocks, without notice, was sustained in a case where an order had been given by an attorney in fact, with full powers, to a broker, "I hereby authorize you to sell in your discretion, at public or private sale and without notice to me, or any notice whatever, the stocks, bonds or gold, which you are or hereafter may be carrying for me, whenever my margin shall fall below five per cent." The powers given under such contract may be exercised by brokers when in good faith and in the exercise of a sound discretion, they deem the state of the market to justify a sale of the stocks they are carrying.[2]

§ 367. The usage as to Notice of sale upon Boards of Trade.—The custom of brokers or commission merchants on Boards of Trade to close a deal, upon the failure of a customer to deposit, after reasonable notice, further margins, the market being unfavorable, and to sell out the commodity purchased, without notice to the customer of the time or place of sale, is supported as a valid usage.[3] The transaction between the parties differs from that of the stockbroker and his customer, and is hardly to be regarded as a pledge of property. The broker upon a Board of Trade does not, in the ordinary trading on "seller's options," receive any property or indicia of property for his customer, but holds merely an executory contract for the delivery thereof upon a certain future option

[1] Baker *v.* Drake, 66 N. Y. 518.

[2] Wicks *v.* Hatch, 62 N. Y. 535.

[3] Denton *v.* Jackson, 106 Ill. 433; Corbett *v.* Underwood, 83 Ib. 324; Lyon *v.* Culbertson, Ib. 33; Moeller *v.* McLason, 60 Ib. 317. A like usage in the New York Cotton Market was supported in Milliken *v.* Dehon, 27 N. Y. 364.

or contingency. The deposit of margins, however, to meet the changes of the market upon the particular option traded in is required. The broker may also demand delivery, at the expiration of the option, if no settlement of the deal has been made prior thereto, and may, where he has sold property, be required to deliver under his contract. To protect himself against this liability, he is entitled to close a deal, without notice, where there is a default in furnishing margins upon reasonable demand. The rules relative to parties to a contract of pledge, requiring notice of sale, are not applicable to such transactions.[1] Such usage must be so uniformly acquiesced in, and for such a length of time, as to force the inference that it was known to the contracting parties, and formed a part of the contract.[2]

§ 368. The Broker's usages, dealing with his Customer's Stock.—A custom among stockbrokers in Boston, in filling orders for stock, deliverable on or before a certain day, at buyer's option, with interest charges, to buy such stock for cash, or on a shorter option, in their own names, and to "turn" the same, or carry it until the maturity of the original contract, charging an additional sum for brokerage, as compensation for such carrying, was held bad, a customer not being chargeable with knowledge of it, and probably bad, any way.[3] Evidence of custom was not permitted that where a customer bought a "straddle," or the double privilege of a "put" and "call," the usage of the broker selling the same was to operate in the stock, holding the "straddle" as a security. It could not be shown as against a customer who had no knowledge of such custom.[4] Nor is evidence permitted to prove a custom of brokers to place stock sent them for sale in their own names on the books of the company, and in making transfers to do

[1] Corbett *v.* Underwood, 83 Ill. 324.

[2] Lyon *v.* Culbertson, 83 Ill. 33.

[3] Day *v.* Holmes, 103 Mass. 306.

[4] Harris *v.* Tunbridge, 83 N. Y. 92.

so indiscriminately without regard to the person from whom the stock was received, or for whose account the stock was sold.[1]

An offer was made to prove a custom on the London stock exchange by which stockbrokers loaning money on securities, such as certificates of stock, with full power to transfer, had a right to sell such securities whenever they might think proper; and that where stock was deposited, and there was no means of identifying it, the practice at the stock exchange was to consider it sufficient to re-transfer the same amount of like stock. A rule of the Exchange was introduced that "in all cases of loans on the deposit of security, the lender is bound to return the identical securities deposited, unless it be otherwise stipulated at the time of the loan." As the alleged custom was in direct opposition to this express rule, it was not supported; although a broker, while not permitted to sell such securities, may transfer the mortgage or pledge by a further mortgage or submortgage. "The lender might suddenly want his money (says Malins, V. C.), and it would indeed be a very hard rule, if he wanted the money he had lent for a certain purpose, if he could not transfer the security to another. That is a right that is not disputed by the original borrower in this case, and is a right that I should consider the lender of money upon any security would have." Nor is there any difficulty in identifying stock, as it is the constant practice of an English court of chancery to trace it when improperly dealt with.[2]

§ 369. The Broker's usage, not to retain identical Certificates or Grain receipts.—The usage of stockbrokers (where not controlled by statutory enactment or express contract) to sell or pledge stocks purchased for their customers, upon margins, is supported as valid. The

[1] Parsons *v.* Martin, 11 Gray, 111.

[2] Langton *v.* Waite, L. R. 6 Eq. 165; ex parte Dennison, 3 Ves. 552.

margin deposited by the customer is generally ten per cent, although other securities may be pledged; but the purchase is made by the broker chiefly with his own funds and in the course of his business. The broker is not generally required under these circumstances to retain the identical shares, so purchased by him for any particular customer, in his possession, since shares of stock bear no "earmarks," but he may use the same in order to raise other moneys wherewith to continue his business, provided he has always had in his possession the like number of shares, and has been ready to fulfil the terms of his contract with the customer by delivering an equal number of like shares as were purchased for him and charged to his account. The business of stock-brokers would soon come to an end if the rule were otherwise, as it would be impossible for them to furnish funds from their private accounts sufficient to carry on the innumerable transactions made every day on Stock Exchanges.[1]

A commission merchant operating on the Board of Trade at Chicago, made advances to a customer upon shipments of grain consigned to him, but which the customer directed not to be sold, but to be held for further orders. The grain was placed in a public warehouse, and receipts issued therefor in the name of the commission merchant, but not show-

[1] Nourse *v.* Prime, 4 Johns. Ch. 490 (Chan. Kent); s. c. 7 Ib. 69; Allen *v.* Dykers. 3 Hill, 593; s. c. 7 Hill, 497; Hardy *v.* Jaudon, 1 Rob. 261; Frost *v.* Clarkson, 7 Cow. 24; Rogers *v.* Gould, 6 Hun, 449; Chamberlain *v.* Greenleaf, 4 Abb. N. Cas. 178; Horton *v.* Morgan, 19 N. Y. 170; Stewart *v.* Drake, 46 Ib. 449; Lawrence *v.* Maxwell, 53 Ib. 19; Taussig *v.* Hart, 58 Ib. 425; Marsten *v.* Marsten, 69 Ib. 220, 226; Ogden *v.* Lathrop, 65 N. Y. 158; Levy *v.* Loeb. 85 N. Y. 370; Thompson *v.* Tolland, 48 Cal. 110; Wood *v.* Hayes, 15 Gray. 375; Price *v.* Grover, 40 Md. 102; Worthington *v.* Torney, 34 Ib. 182; Berlin *v.* Eddy, 33 Mo. 426; Boylan *v.* Huguet, 8 Nev. 345; Gilpin *v.* Howell, 5 Pa. St. 41; Wynkoop *v.* Leal, 64 Ib. 361; Neiler *v.* Kelly, 69 Pa. St. 409; Noyes *v.* Spaulding, 27 Vt. 420; Hubbell *v.* Drexel, 11 Fed. Rep. 115. But a pledge of fifty shares of "Consolidated" Erie stock cannot be made good to the pledgor by transferring to him fifty shares of "Converted" Erie stock. Wilson *v.* Little, 2 N. Y. 443. Lecroy *v.* Eastman, 10 Mod. 499; Shales *v.* Seignoret, 1 Ld. Raym. 440; Mocatta *v.* Bell, 27 L. J. Ch. 237.

ing the name of the consignor. The commission merchant immediately sold these warehouse receipts, retaining however enough warehouse receipts in his possession to represent the aggregate amount of grain received from his customers. It was established by evidence that, in the transaction of business on Boards of Trade by its members there was a custom and usage, in holding grain consigned to them, or in making sales of it on account of any particular shipper, to pay no attention to the matter of holding or transferring the identical receipts which were received when that customer's grain was warehoused, but that such receipts were used indiscriminately. The usage was sustained as valid, although sufficient grain receipts had not been retained to meet the claims of all customers. In such a case the question is one of storage and insurance, rather than an action for conversion. The property of the customer entirely ceases in the special shipment of grain, by its delivery into a public elevator, the receipts being simply evidence of a debt to the commission merchant holding the receipts, who becomes a debtor to the owner, instead of remaining a bailee of his property.[1]

§ 370. The Broker's usages, as to Funds, charges and interest. — An effort was made to prove a custom among brokers, when dealing with brokers in other cities, to put all transactions into one account, and remit and draw for the general balance. "If there is a custom (said the court) among stockbrokers, when dealing with others, to appropriate money belonging to the principal to the payment of the broker's indebtedness, the sooner it is abolished the better—*malus usus est abolendus.* A custom so iniquitous can never obtain the force or sanction of law, and the marvel is, that it should be set up as a defense to this action."[2] The like rule was applied where grain brokers

[1] Bailey *v.* Bensley, 87 Ill. 556.

[2] Evans *v.* Waln, 71 Pa. St. 69. Waln employed a broker to sell certain railroad stocks. The broker placed them in the hands of one Wister, a broker, who sent them to

entered into an arrangement with an agent at Baltimore to put all transactions between them "into one general account, and remit or draw for the general balance." The rights of a customer, ignorant of the arrangement, were supported as against the brokers, notwithstanding the account of the brokers and their agent had been closed at a loss to the former.[1] Evidence was received of the custom of the Board of Brokers in the issue of contracts for the sale of mining stock, containing a receipt for the payment of the first instalment, to issue the same without the money having been actually paid.[2] Upon the insolvency of a stockbroker, and the settlement of his trades, the usage is supported of appropriating the proceeds of his deals by the official assignee of the Stock Exchange first in payment of differences due by the defaulting broker to members, although the settlement is not exclusive, as both brokers and creditors can pursue other remedies and suits to obtain satisfaction.[3]

A custom of stockbrokers to debit and credit interest monthly, computing interest on balances, is supported. Such a mode of computing interest, although in one contingency, it involves compound interest, does not necessarily involve usury, as the balance may be paid at any time ; nor does it affect a contract for the purchase and sale of stocks, being wholly independent of it.[4] But a custom of charging

the defendants, brokers in New York. The latter sold the stock, but Wister having failed, indebted to them, they insisted upon deducting from the proceeds of the stock the balance due them from him on general account. The like principle was applied in Talmadge *v.* Third Nat. Bank, 91 N. Y. 531; Semenza *v.* Brinsley, 18 C. B. N. S. 467 ; Cheap *v.* Cranwood, 4 B. & A. 663.

[1] Scarlett *v.* Van Inwagen, 9 Biss. 157.

[2] Winans *v.* Hassey, 48 Cal. 634.

[3] Ex parte Grant, L. R. 13 Ch. D. 667. By rules 167, 169 & 170 of the London Stock Exchange (1881) creditors outside the board are allowed to join, if they wish, in the distribution of the funds held by the official assignee of the board. Ex parte Ward, L. R. 20 Ch. D. 356.

[4] Hatch *v.* Douglass, 41 Conn. 116.

customers an arbitrary rate for telegrams, as if a special dispatch were sent, when in fact several of such messages are sent in one dispatch, at much less expense, is not favored, in the absence of knowledge by the customer.[1]

Evidence was refused when offered to establish a custom to change the rule that on a sale of stock deliverable at a future day at the option of the seller, dividends declared before the day of sale, but not payable until after the day for delivery, belong to the seller, on the ground that the contract was to sell so many shares of stock, and the custom would have passed something more.[2] And in another case, evidence as to the meaning attributed to the words "dividends on" and "ex-dividend" by the custom of stock-brokers, was not permitted, as it would have had the effect of changing the contract between the parties.[3]

§371.—The Broker's usage as to "Name-day."—The usage prevailing on the London Stock Exchange, that in transactions between its members, there is an implied understanding that, on the purchase of stock, the buying jobber shall be at liberty by a given day, called the "name-day," to substitute another person as buyer, and so relieve himself from further liability on the contract, provided such substituted person be one to whom the original seller cannot reasonably except, and that such person accept a transfer of the stock, and pay to the original seller the price, is upheld as reasonable.[4] The name given, however, must be that of a person able and willing to purchase, and not that of a non-existent person, lunatic, infant, married woman, or one not consenting thereto.[5] The giving of the name of a

[1] Marye *v.* Strouse, 5 Fed. Rep. 486.

[2] Spear *v.* Hart, 3 Robt. 420.

[3] Lombardo *v.* Case, 45 Barb. 95.

[4] Grissell *v.* Bristowe, L. R. 4 C. P. 36, reversing s. c. L. R. 3 C. P. 112; Allen *v.* Graves, L. R. 5 Q. B. 478.

[5] Nickalls *v.* Merry, L. R. 7 Ch. 533; s. c. 7 H. L. 530; disapp. Rennie *v.* Morris, L. R. 13 Eq. 203, where such a transaction, in the absence of fraud, had been supported. Maxted *v.* Paine, L. R. 4 Ex. 81; Heritage *v.* Paine, L. R. 2 Ch. D. 594.

person legally competent to hold the stock but of no means, and who consented to allow the use of his name for a small consideration, was regarded as a sufficient compliance with the usage.[1] Where the vendor, by reason of accidental omission, intervening insolvency of the company, or the giving the name of a mere nominee of the purchaser, remains still subject to liability as a stockholder, he has his action against the purchaser,[2] or against the broker, where the latter has agreed on the sale-note "registration guaranteed."[3]

§ 372.—Usages of Brokers, not binding upon Customers.—A custom of stockbrokers, upon receipts of orders from customers to purchase stocks, to buy such stocks of themselves, is not supported, as it changes the character of the broker and the nature of the transaction.[4] And a usage of brokers to recognize only the party employing them, and to obey his directions in the disposal of the proceeds of a sale, is not upheld, where the brokers are chargeable with notice that the shares dealt in are not the property of the solicitor ordering their sale, but belong to an estate.[5] A customer is not liable for any loss resulting to his broker by reason of the latter's insolvency, notwithstanding any usage on the stock exchange to insist upon such liability;[6] nor where, by custom of brokers, the dealings of the broker were conducted in an invalid manner;[7] nor is he required to submit to an arbitration of any claim, held under the rules of an Exchange.[8] A customer of a broker or a commission merchant,

[1] Maxted *v.* Paine, L. R. 4 Ex. 81.

[2] Castellan *v.* Hobson, L. R. 10 Eq. 47; Shepherd *v.* Gillespie, 5 Ib. 293; s. c. 3 Ch. 764; Evans *v.* Wood, L.R. 5 Eq. 9; Brown *v.* Black, L. R. 15 Eq. 363; s. c. 8 Ch. 939; Bowring *v.* Shepherd, L. R. 6 Q. B. 309; Hodgkinson *v.* Kelly, L. R. 6 Eq. 496. A contrary view was taken in Torrington *v.* Lowe, L. R. 4 C. P. 26.

[3] Cruise *v.* Paine, L. R. 6 Eq. 641; s. c. 4 Ch. 441.

[4] Pickering *v.* Demeritt, 100 Mass. 416; Robinson *v.* Mollett, L. R. 7 H, L. 802.

[5] Pearson *v.* Scott, L. R. 9 Ch. D. 198.

[6] Duncan *v.* Hill, L. R. 6 Ex. 255; s. c. 8 Ex, 242.

[7] Neilson *v.* James, L. R. 9 Q. B. D. 546.

[8] Williamson *v.* Ellis, 12 Phila. 338.

sold out for want of margins, has a right to know from the evidence whether the mode of dealing adopted by the commission merchant was fair, and free from all fraud, injustice or wrong to him. Commission merchants and brokers have no right to adopt methods in making purchases for their customers that they can refuse to explain, or that are so intricate or tortuous that they are incapable of being explained to the full comprehension of ordinarily intelligent men.[1]

In a leading Massachusetts case, Shaw *v.* Spencer,[2] an offer was made to show, 1, that it was a matter of common occurrence for certificates of stock to be issued in the name of some other person as trustee, when in fact there was not any trust; 2, whether certificates of stock, issued to a designated person as trustee, were constantly bought and sold in the stock market, by a simple indorsement of the certificate by the person named as the holder, without inquiry as to the authority by which, or the use or purpose for which the transfer was made. As to the first, "the law holds (say the court) that the insertion of the word 'trustee' after the name of a stockholder does indicate and give notice of a trust. No one is at liberty to disregard such notice, and to abstain from inquiry for the reason that a trust is frequently simulated or pretended when it really does not exist. The whole force of this offer of evidence is addressed to the question whether the word 'trustee' alone has any significance, and does amount to notice of a trust, and it has been decided that it does."[3] As to the second offer, the court added, "a usage to disregard one's legal duty, to be ignorant of a rule of law, and to act as if it did not exist, can have no standing in the courts."

[1] Oldershaw *v.* Knowles, 101 Ill. 117.

[2] 100 Mass. 382.

[3] Sturtevant *v.* Jaques, 14 Allen, 523.

Div. 2.—BILLS OF LADING.

CHAPTER XXXVIII.

THE BILL OF LADING.

§373. The bill of lading as collateral security.
374. The bill of lading.
375. The bill of lading quasi-negotiable.
376. The foreign view of bills of lading.
377. Glyn, Mills, Currie & Co. *v.* East & West India Docks Company.
378. Bills of lading made negotiable by statute.
379. The bill of lading a symbol of property.

§ 373.—The Bill of lading as Collateral Security. —Bills of lading were among the earliest documents of title used in the commercial world for the purposes of collateral security. The amounts advanced by those who lend money on the security of bills of lading are enormous.[1] The discount by banks of bills of exchange, drawn upon consignees, for the purchase money of goods, the bill of lading being delivered as collateral security for its payment, or loans upon the deposit of bills of lading by the consignee, where they have been forwarded, in order to raise funds to pay the bills of exchange drawn for the purchase price, are common forms of loaning money. A bill of lading in Europe is a negotiable instrument, but in this country its character, even under statutes providing that transfer shall be made "in the same manner as bills of exchange and prom-

[1] Glyn *v.* E. &W. India Docks, L. R. 7 App. 613 (Lord Blackburn).

issory notes," is quasi-negotiable only. In the absence of other words, such provisions relate to the manner of transfer, and do not give to a bill of lading the privileges belonging to the favored instruments of commerce. The title of the pledgee for value of bills of lading is preferred as against the lien of the unpaid vendor, although the bills of exchange drawn for the price of the goods are certain to be dishonored, provided the lender is without knowledge or notice of any fact upon which the vendor's right of stoppage *in transitu* may arise. The pledgee's title is founded upon a right, either general or special, to the property represented by the bill of lading, and to its possession; and is protected as between the parties to the contract of pledge, and as against third parties, carriers, pledgees, or purchasers, dealing with the goods tortiously or without authority, or with notice, actual or presumptive, of the indorsement for value as collateral security of the bill of lading. The only limitation upon his claim is, that where bills of lading are issued in sets of three, a bona fide delivery by the ship-owner to the person first presenting one of such bills of lading, is a valid discharge of his contract, although other bills of the set are in the hands of a pledgee for value advanced prior to the time of delivery, the ship-owner being without knowledge or notice of such transfer. As between successive pledgees, the holder of the bill first indorsed is preferred.[1]

[1] Pollard *v.* Vinton, 105 U. S. 5; Shaw *v.* Railroad Company, 101 Ib. 504; Gibson *v.* Stevens, 8 How. 384; The Thames, 14 Wall. 98; Robinson *v.* Memphis Ry. Co. 9 Fed. Rep. 133; Loeb *v.* Peters, 63 Ala. 243; Stone *v.* West St. L. Transf. Co. 9 Bradw. 48; Cairo National Bank *v.* Crocker, 111 Mass. 163; Stollenwerck *v.* Thacher, 115 Mass. 224; Forbes *v.* Boston & L. Ry. Co., 133 Mass. 154; s. c. 9 Am. & E. R. R. Cas. 76; Lee *v.* Kimball, 45 Me. 172; Tiedeman *v.* Knox, 53 Md. 612; Farmers' Bank *v.* Logan, 74 N. Y. 568; Marine Bank *v.* Fiske, 71 Ib. 353; Farmers' Bank *v.* Haseltine, 78 Ib. 104; Becker *v.* Hallgarten, 86 Ib. 167; Emery's Sons *v.* Irving Nat. Bank, 25 Ohio St. 360; Holmes *v.* German Security Bank, 87 Pa. St. 525; Holmes *v.* Bailey, 92 Pa. St. 57; Meyerstein *v.* Barber, L. R. 2 C. P. 57, 675; s. c. 4 H. L. 325; ex parte Golding, L. R. 13 Ch. D. 624; Glyn *v.* E. & W. Ind. Docks Co. L. R. 7 App. 591; Gurney *v.* Behrend, 3 El. & Bl. 633; in re Westzinthus, 5 B. & Ad. 817; San-

§ 374.—THE BILL OF LADING.—A bill of lading is a memorandum or acknowledgment in writing signed by the captain or master of a ship or other vessel that he has received in good order on board of his ship or vessel therein named at the place therein mentioned, certain goods therein specified, which he promises to deliver in like good order (the dangers of the sea excepted) at the place therein appointed for the delivery of the same to the consignee therein named, or to his assigns, he or they paying freight for the same.[1] A bill of lading issued by a railroad company or other inland common carrier, is a receipt for the property described therein, and a contract to carry the same to a place therein named, and to deliver to a person named, or order, or bearer.[2] As between common carriers on land and common carriers on water, the law draws no distinction. They are each subject, in issuing bills of lading, to the same obligations and liabilities, and to the same duties, and entitled to the same protection.[3]

§ 375.—THE BILL OF LADING QUASI-NEGOTIABLE.—A bill of lading is primarily a contract between a ship-owner and shipper or inland carrier and shipper for the carriage and delivery of property. As between the parties to the contract, the bill of lading has no elements of negotiability. It is only after a general indorsement or transfer of the bill of lading by the owner, and when it has passed into the hands of a bona fide pledgee or other holder for value, that quasi-negotiability arises. The transfer of such bill of lading is as effective in vesting title to the goods represented as if they were actually in possession of the person loaning

ders *v.* Maclean, L. R. 11 Q. B. D. 327.

[1] Abbott's Shipp. 216; Hibbert *v.* Carter, 1 Term, 745; Bouvier's Law Dict. Vol. 1, 246; Code de Comm. art. 281.

[2] National Bank *v.* Dearborn, 115 Mass. 219; Newcomb *v.* Railroad Co. Ib. 230; Seymour *v.* Norton, 105 Ill. 272; Michigan Cent. R. R. Co. *v.* Phillips, 60 Ill. 190; Taylor *v.* Turner, 87 Ib. 296.

[3] King *v.* Shepherd, 3 Story, 349 (Story, J.) "A ship is a common carrier like any other." Elliott *v.* Russell, 10 Johns. 1.

money, although such indorsement and delivery of a bill of lading carries with it no such fixed legal results as in the case of negotiable instruments.[1] So long as the bill remains in the hands of an agent entrusted with it for a special purpose, as shown upon its face or by indorsement, or not authorized to pledge, a holder for value can acquire no title as against the owner, through any act of misappropriation or fraud of the agent, or by an act not authorized.[2] The maker of a bill of lading is not in the same position as the maker of commercial paper, bound to protect it although misappropriated, when in the hands of an innocent holder for value.[3] Where, however, there has been a general indorsement or assignment of the bill of lading by the original holder, any subsequent bona fide pledgee, advancing value thereon, without notice, is protected, although as between the original parties, a secret agreement existed as to the use to be made thereof of which the act of pledge was a breach. A pledgee for value advanced in good faith, without notice, obtains, under such indorsement and delivery, a good title as against the owner.[4]

[1] Stone *v.* West St. Louis Transf. Co. 9 Bradw. 48; Glyn *v.* E. & W. Ind. Docks Co. L. R. 7 App. 591; Security Bank *v.* Luttgren, 29 Minn. 363; Stollenwerck *v.* Thacher, 115 Mass. 224. In Pollard *v.* Vinton, 105 U. S. 8, the United States Supreme Court (Miller, Jus.) describe a bill of lading as being "an instrument well known in commercial transactions, and its character and effect have been defined by judicial decisions. In the hands of the holder it is evidence of ownership, special or general, of the property mentioned in it, and of the right to receive said property at the place of delivery. Notwithstanding it is designed to pass from hand to hand, with or without indorsement, and it is efficacious for its ordinary purposes in the hands of the holder, it is not a negotiable instrument or obligation in the sense that a bill of exchange or a promissory note is. Its transfer does not preclude, as in those cases, all inquiry into the transaction in which it originated, because it has come into hands of persons who have innocently paid value for it. The doctrine of bona fide purchasers only applies to it in a limited sense."

[2] Voss *v.* Robertson, 46 Ala. 483; Stollenwerck *v.* Thacher, supra, Robinson *v.* Memphis R. R. Co. 9 Fed. Rep. 133; Farmers' Bank *v.* Logan, 74 N. Y. 568.

[3] Robinson *v.* Memphis R. R. Co. 9 Fed. Rep. 133.

[4] Stollenwerck *v.* Thacher, 115 Mass. 224; Farmers' Bank *v.* Hazel-

§ 376.—The Foreign view of Bills of lading.—The effect of a transfer of a bill of lading was considered in an early English case, by Lord Campbell, and his view of it was followed for some years. He declared that "a bill of lading is not, like a bill of exchange or promissory note, a negotiable instrument, which passes by mere delivery to a bona fide transferee for valuable consideration, without regard to the title of the parties who make the transfer. Although the shipper may have indorsed in blank a bill of lading deliverable to his assigns, his right is not affected by an appropriation of it without his authority. If it be stolen from him, or transferred without his authority, a subsequent bona fide transferee for value, can not make title under it as against the shipper of the goods. The bill of lading only represents the goods; and in this instance, the transfer of the symbol does not operate more than a transfer of what is represented."[1] But, in the leading case of The Marie Joseph,[2] the Lord Chancellor (Lord Chelmsford) distinguished the above decision as being very carefully confined in its terms to the original transfer of a bill of lading deliverable to the assigns of the shipper, and that in the cases supposed, as there could be no lawful assigns of the shipper, the bill of lading consequently could have no existence as a negotiable instrument. In the case stated, a bill of lading was indorsed as collateral security, for a valuable consideration,

tine, 78 N. Y. 104, 108; The Argentina L. R. 1 A. & E 370.

[1] Gurney *v.* Behrend, 3 El. & Bl. 633.

[2] L. R. 1 Pr. C. 219. A bill of lading, indorsed by the consignor, was delivered to the purchaser for his acceptances of bills of exchange, payable at three months. The bill of lading was immediately delivered to an agent of the consignor, to hold as security for the payment of the bill of exchange. A member of the firm of purchasers again obtained the bill of lading by fraudulent misrepresentations, and indorsed and delivered it to his bankers as security for advances already made and to be made. Further advances were afterwards made. Before the arrival of the goods the agent became bankrupt, and the vendors sought to reclaim the goods. As the advances of the pledgees were made bona fide, and without notice of the fraud, the right of the vendors to stop the goods in transitu was defeated to the extent of the advances made.

without notice of equities arising from an act of misappropriation, and it was held a bill of lading for the delivery of goods to "order and assigns," is a negotiable instrument, which, by delivery and indorsement, passes the property in the goods to the indorsee, subject only to the right of the unpaid vendor to stop them *in transitu*. The indorsee may deprive the vendor of this right by indorsing the bill of lading for a valuable consideration, although the goods are not paid for, or bills have been given for the price of them which are certain to be dishonored, provided the indorsee for value has acted in good faith, and without notice. Where a bill of lading omits " or order or assigns " it is not *semble* a negotiable instrument.[1] The French code recognizes the negotiability of bills of lading,[2] and in Germany, and under the Spanish code, they are treated generally as bills of exchange.[3]

§ 377. GLYN, MILLS, CURRIE & CO. v. EAST AND WEST INDIA DOCKS CO.—In the latest decision of the English House of Lords arising out of the negotiation as collateral of bills of lading,[4] the Lord Chancellor (Lord Selborne) held

[1] Henderson *v.* Comptoir d'Escompte, L. R. 5 Pr. C. 253.

[2] Code de Comm. liv. 2, lit. 7, art. 281.

[3] Meyerstein *v.* Barber, L. R. 2 C. P. 57.

[4] Glyn, Mills & Co. *v.* E. & W. India Docks Co., L. R. 7 App 591. Goods were shipped for London, the master signing a set of three bills of lading, marked first, second, and third respectively, making the goods deliverable to the consignees named, or their assigns, "the one of which bills being accomplished, the others to stand void." During the voyage the consignees indorsed the bill of lading marked "first" to the plaintiffs, a banking firm, as security for a loan. The goods upon arrival were landed at the docks of the defendant, and placed in their warehouse by the shipowner, with a stop-order for freight. The consignees produced to the dock company the bill of lading marked "second," unindorsed, the property being deliverable to them, or their assigns, and were registered as the owners of the goods upon removal of the stop for freight. The dock company, in good faith and without notice of the bankers' claim, delivered the property to third persons upon delivery-orders, signed by the consignees. The trial court found in favor of the pledgee (L. R. 5 Q. B. D. 128); but the judgment was reversed in

that "the primary office and purpose of a bill of lading, although by mercantile law and usage it is a symbol of the right of property in the goods, is to express the terms of the contract between the shipper and the shipowner. It is for the benefit of the shipper that the right to take delivery of the goods is made assignable, and it is for the benefit and security of the shipowner that when several bills of lading, all of the same tenor and date, are given as to the same goods, it is provided that 'the one of these bills being accomplished, the others are to stand void.' It would be neither reasonable nor equitable, nor in accordance with the terms of such a contract, that an assignment, of which the shipowner has no notice, should prevent a bona fide delivery under one of the bills of lading, produced to him by the person named on the face of it as entitled to delivery (in the absence of assignment), from being a discharge to the shipowner. Assignment, being a change of title since the contract, is not to be presumed by the shipowner in the absence of notice, any more than a change of title is to be presumed in any other case when the original party to a contract comes forward and claims its performance, the other party having no notice of anything to displace his right. He has notice indeed that an assignment is possible, but he has no notice that it has taken place. There is no proof of any mercantile usage putting the shipowner, in such a case, under an obligation to inquire whether there has in fact been an assignment or not; and, in the absence of such usage, I am of opinion that it is for the assignee to give notice of his title to the shipowner, if he desires to make it secure, and not for the shipowner to make any such inquiry."

§ 378. Bills of lading made Negotiable by Statute. —The character and mode of transfer of bills of lading have

the court of appeals (L. R. 6 Q.B.D. 476). Upon appeal to the House of Lords, the latter judgment was affirmed.

been made the subject of statutory enactment in certain states, and the element of negotiability, more or less restricted, conferred upon them. In Maryland, in the case of Baltimore & Ohio Railroad Company *v.* Wilkins,[1] a bill of lading was held not to be negotiable in the same sense as bills of exchange and promissory notes, but soon after, the Legislature of that state enacted a public act,[2] declaring that bills of lading should be negotiable instruments and securities (unless provided in express terms to the contrary on the face thereof) "in the same sense as bills of exchange and promissory notes," and in the hands of bona fide holders for value, without notice, be as equally free from all antecedent equities. This statute was enforced in Tiedman *v.* Knox.[3] The statutes of Pennsylvania and of Missouri provide that bills of lading shall be negotiable by written indorsement and delivery "in the same manner as bills of exchange and promissory notes." The effect of these statutes where the bill of lading negotiated has been lost or stolen without negligence, or the pledgee is chargeable with knowledge that the pledgor is not the owner, or that the bill is held as security to pay an outstanding draft, is not to entitle the innocent pledgee, for value, to all the privileges which attach to the holder of negotiable instruments for value before maturity in good faith, under circumstances of fraud or misappropriation; nor is the pledgee charged with the duty of demand, or notice of non-delivery, nor are indorsers liable as on promissory notes or bills of exchange,[4]

[1] 44 Md. 11.

[2] Acts of Maryland, 1876, Ch. 262.

[3] 53 Md. 612.

[4] Shaw *v.* Railroad Company, 101 U. S. 564. A time draft, drawn by a consignor at St. Louis, upon a consignee in Philadelphia, was discounted by a bank at St. Louis, with bill of lading, duly indorsed, attached as collateral security. A duplicate bill of lading was sent to the consignee. Upon presentation of the draft for acceptance the consignee feloniously substituted his duplicate for the original. This exchange of bills was not noticed by the bank until some time afterwards; but on the same day the consignee re-indorsed the bill of lading, and obtained another loan from a third person. As the second pledgee was chargeable with notice that the bill

although the usual indorsement "without recourse" is sometimes made.[1]

§ 379. THE BILL OF LADING A SYMBOL OF PROPERTY.— Bills of lading are symbols of the property described therein. They are regarded as so much grain, provisions, cotton, iron, or other articles of property, and the merchandise is very often sold or pledged by the transfer of the symbol, the bill of lading covering the goods. Bills of lading have resulted from the adoption of a mode of dealing by symbols with property the possession of which cannot be immediately delivered. In the case of goods which are at sea, being transmitted from one country to another, actual possession of them cannot be delivered, and therefore the bill of lading is considered a symbol of the goods, and its delivery a delivery of them. When the goods have arrived at the dock, until they are delivered to some person who has the right to hold them, the bill of lading still remains the only symbol that can be dealt with by way of assignment, or mortgage, or pledge, or otherwise. As soon as delivery is made, or a warrant for delivery has been issued, or an order for delivery accepted (which in law is equivalent to delivery), then those symbols replace the symbol which before existed. Until that time bills of lading are effective representatives of the ownership of the goods, and their force does not become extinguished until possession, or what is equivalent in law to possession, has been taken on the part of the person having a right to demand it.[2]

of lading in the possession of the consignee had already been indorsed as collateral security for the payment of an outstanding draft, purchasers of the property from him could take no greater rights than he himself had as against the bank, the purchase of the property having been made without requiring production of the bill of lading or other evidence of title.

[1] Farmers' Bank *v.* Hazeltine, 78 N. Y. 104; Farmers' Bank *v.* Atkinson, 74 Ib. 587.

[2] Gibson *v.* Stevens, 8 How. 384; Dows *v.* Nat. Exchange Bank, 91 U. S. 618; Shaw *v.* Railroad Company, 101 Ib. 564; Holbrook *v.* Wright, 24 Wend. 169; Grosvenor *v.* Phillips, 2 Hill, 147; Bank of Rochester *v.* Jones, 4 N. Y. 497; Rawles *v.* Deshler, 42 Ib. 572; Marine Bank *v.*

CHAPTER XXXIX.

BILLS OF LADING AS COLLATERAL.

§380. The title of the pledgee of bills of lading.
381. The pledge of bills of lading under indorsement.
382. The pledge of bills of lading unindorsed.
383. The pledge of unindorsed bills of lading, as to third parties.
384. Pledges of bills of lading for antecedent debt and future advances.
385. And of reversionary interests in bills of lading.

§ 380. THE TITLE OF THE PLEDGEE OF BILLS OF LADING.—The transfer of a bill of lading as collateral security to a pledgee, who has advanced money, or discounted commercial paper, in good faith on the credit of the representations contained therein, without notice, vests in him the legal title to the property and the right of possession, and his title is good against all the world.[1] No distinction is

Wright, 48 Ib.; First Nat. Bank *v.* Kelly, 57 Ib. 34; Farmers' etc. Bank *v.* Logan, 74 Ib. 568; DeWolf *v.* Gardner, 12 Cush. 19; Allen *v.* Williams, 12 Pick. 290; First National Bank *v.* Dearborn, 115 Mass. 219; National Bank *v.* Crocker, 111 Ib. 163; Hathaway *v.* Haynes, 124 Ib. 311; Security Bank *v.* Luttgren, 29 Minn. 363; Michigan Cent. R. R. Co. *v.* Phillips, 60 Ill. 190; Peters *v.* Elliott, 78 Ib. 326; Taylor *v.* Turner, 87 Ib. 296; Pettit *v.* First Nat. Bank, 4 Bush, 334; Emery *v.* Irving Nat. Bank, 25 Ohio St. 360, 366; Henry *v.* Philadelphia Warehouse Co. 81 Pa. St. 76; Haille *v.* Smith, 1 B. & P. 563; Gurney *v.* Behrend, 6 El. & B. 622; Jenkyns *v.* Brown, 14 Q. B. 496; The Marie Joseph, L. R. 1 Pr. C. 219; The Argentina, L. R. 1 A. & E. 370; Shepherd *v.* Harrison, L. R. 5 H. L. 116; Barber *v.* Meyerstein, L. R. 2 C. P. 33, 661; 4 H. L. 317, 329 (Hatherly, Lord Chan.); Sanders *v.* Maclean, L. R. 11 Q. B. D. 327 (Bowen, L. J.).

[1] Farmers' Nat. Bank *v.* Logan, 74 N. Y. 568; First Nat. Bank *v.* Kelly, 57 Ib, 34; Commercial Bank *v.* Pfeifer, 22 Hun, 327; Forbes *v.* Boston & Lowell R. R. Co. 133 Mass. 154; Cairo National Bank *v.* Crocker, 111 Mass. 163; National Bank *v.* Bailey, 115 Ib. 288; De Wolf *v.* Gardner, 12 Cush. 19; Eme-

drawn between the title of the pledgee who has received a bill of lading as collateral security upon a valuable consideration, without notice, and an actual purchaser. The legal title to the property passes to the pledgee as to the purchaser; and to the extent of his advances, the pledgee for value has all the protection afforded the purchaser for value.[1] Holding this legal title to the property comprised in the bill of lading, although for the purposes of collateral security only, third persons dealing with the property thus shipped are chargeable with notice, actual or constructive, as the case may be, of the terms of the bill of lading, so that, although advancing value, and acting in good faith, in the usual course of business, they can acquire no rights in opposition to those of the pledgee in the property covered by the bills of lading.[2] The pledgee is also entitled, having the legal property in and at law the right to the possession of the goods described in the bill of lading, to maintain an action against any one who, without justification or legal excuse, wrongfully converts them.[3] Such transfer of a bill of lading operates as a delivery of the goods while in the possession of the carrier, and is as effectual as if the goods having arrived an actual delivery were made, vesting a general or special ownership in such property.[4] The transfer effects an appro-

ry's Sons *v.* Bank, 25 Ohio St. 360; Holmes *v.* Bailey, 92 Pa. St. 57; Holmes *v.* Bank, 87 Ib. 525; Gibson *v.* Stevens, 8 How. 384; Lee *v.* Bowen, 5 Biss. 154; Glyn *v.* Docks Co., L. R. 7 App. 591; Burdick *v.* Sewell, 13 Q. B. D. 159.

[1] Gibson *v.* Stevens, 8 How. 384; Farmers' Bank *v.* Logan, 74 N. Y. 568; Commercial Bank *v.* Pfeifer, 22 Hun, 327.

[2] First Nat. Bank *v.* Kelly, 57 N. Y. 34; Farmers' Nat. Bank *v.* Logan, 74 Ib. 568.

[3] Dows *v.* National Exchange Bank, 91 U. S. 618; Forbes *v.* Boston & L. R. R. Co. 9 Am. & E. R.R. Cas. 76; Hathaway *v.* Haynes, 124 Mass. 311; Cairo Nat. Bank *v.* Crocker, 111 Ib. 163; DeWolf *v.* Gardner, 12 Cush. 19; Glyn *v* E. & W. Ind. Docks Co. L. R. 7 App. 591, 606.

[4] Pollard *v.* Vinton, 105 U. S. 3; Dows *v.* Greene, 24 N. Y. 638; Commercial Bank *v.* Pfeifer, 22 Hun, 327; Meyerstein *v.* Barber, L. R. 2 C. P. 53 (Erles, C. J., Willes, Keating, J. J.) Ib. 675 (Lush, J.) 4 H L. 325 (Hatherly, Ld. Chan.); Glyn *v.* E. & W. Ind. Docks Co. L. R. 7 App. 591, 606.

priation of the goods, and change in their possession, for the benefit of the pledgee advancing money, without notice of equities, on the bills of lading.[1] It has always been considered a pledge of the goods covered by its terms,[2] or a mortgage of the goods and the returns, subject to be defeated by a performance of the conditions, the holder of the bill being a mortgagee in actual possession.[3]

§ 381. THE PLEDGE OF BILLS OF LADING UNDER INDORSEMENT.—In the absence of statutory enactments making bills of lading negotiable instruments in the same sense as bills of exchange and promissory notes, the indorsement of a bill of lading is not such a written contract having a fixed, definite meaning in the law, and presumably complete in itself, as to exclude from consideration all express parol agreements as to the conditions annexed to their transfer; nor all inquiry into the transactions out of which they arise.[4] A bill of lading is properly transferable by indorsement, where made to the order of a particular person named, or assigns. When presented by the person actually named, the necessity for indorsement does not exist, and a valid delivery may be made by a shipowner or dock company to such consignee holding the "second" of a set of bills of lading unindorsed, although the "first" of the same be pledged indorsed for value, upon a bona fide loan, but of which neither shipowner nor dock company are chargeable with notice.[5] The transfer by indorsement where made to order of A, "or assigns," is necessary to pass the title to

[1] Holmes *v.* Bailey, 92 Pa. St. 57; Holmes *v.* German Security Bank, 87 Ib. 525; First Nat. Bank *v.* Kelly, 57 N. Y. 34; Emery's Sons *v.* Irving Nat. Bank, 25 Ohio St. 360; Lee *v.* Bowen, 5 Biss. 154.

[2] First Nat. Bank *v.* Kelly, 57 N. Y. 34; Pettit *v.* First Nat. Bank, 4 Bush, 334; Meyerstein *v.* Barber, L. R. 2 C. P. 676 (Martin, B.).

[3] Conrad *v.* Atlantic Ins. Co. 1 Pet. 447; Bank of Rochester *v.* Jones, 4 N. Y. 497; Marine Bank *v.* Wright, 48 Ib. 1; Farmers' Nat. Bank *v.* Logan, 74 N. Y. 568.

[4] Security Bank *v.* Luttgren, 29 Minn. 362; Dows *v.* Bank, 91 U. S. 618, 633.

[5] Glyn *v.* E. & W. Ind. Docks Co., L. R. 7 App. 591.

the goods.[1] Indorsements in blank are sufficient to pass the legal title,[2] but an indorsement, without delivery, is a nullity.[3]

Indorsement of the bill of lading is required in England to pass the title to the property represented by it, although where actual possession of the property has been obtained, under an unindorsed bill of lading, the title of the holder of the bill is protected.[4] Ordinarily, no rights can be acquired under the delivery of an unindorsed bill of lading. In a leading case, at an early day, a consignor of goods sent to a consignee, with the usual invoice, an unindorsed bill of lading, and at the same time, forwarded an indorsed bill of lading to his agent, accompanied by a bill of exchange, to be presented for acceptance, upon the accomplishment of which the indorsed bill of lading was to be delivered. Upon a refusal to accept the bill of exchange, the title to the property remained in the consignor, no interest passing by the mere delivery of an unindorsed bill of lading.[5] In a later case, where no bill of lading was sent to the consignee with the invoice of the goods, but the bill, attached to a bill of exchange drawn upon the consignee, was sent to the

[1] Conrad *v.* Atlantic Ins. Co. 1 Pet. 445; The Thames, 14 Wall. 106; Gibson *v.* Stevens, 8 How. 384; Shaw *v.* Railroad Co. 101 U. S. 564; Walter *v.* Ross, 2 Wash. 283; Michigan Central R. R. Co. *v.* Phillips, 60 Ill. 198; Western Union R. R. Co. *v.* Wagner, 65 Ib. 198; Skilling *v.* Bollman, 73 Mo. 665; Thompson *v.* Dominy, 14 M. & W. 403; Caldwell *v.* Ball, 1 Term, 205; Wright *v.* Campbell, 2 Burr. 2051; Kreft *v.* Thompson, L. R. 10 Ex. 285; Short *v.* Simpson, L. R. 1 C. P. 248; Glyn *v.* E. & W. I. Docks Co., L.R. 7 App. 591; Henderson *v.* Comptoir, L. R. 5 Pr. C. 253.

[2] Shepherd *v.* Harrison, L. R. 4 Q. B. 204; Hobart *v.* Littlefield, 13 R. I. 341.

[3] Buffington *v.* Curtis, 15 Mass. 528.

[4] Kreft *v.* Thompson, L. R. 10 Ex. 285; Short *v.* Simpson, L. R. 1 C. P. 248; Shepherd *v.* Harrison, L. R. 4 Q. B. 204; Coxe *v.* Harden, 4 East, 211, 217; Thompson *v.* Dominy, 14 M. & W. 403; Wait *v.* Baker, 2 Ex. 1; Henderson *v.* Comptoir, L. R. 5 Pr. C. 253.

[5] Brandt *v.* Bowlby, 2 B. & Ad. 932. A mere delivery of an unindorsed bill of lading is not sufficient to constitute an appropriation of the property. Wait *v.* Baker, 2 Ex. 1, 5.

agent of the consignor at the same place to be delivered upon acceptance of the bill of exchange, Cockburn, C. J. of the Court of Queen's Bench, said: "Here we have not an unindorsed bill of lading sent to the consignee, but no bill of lading at all sent. I see no difference in principle between sending a bill of lading which, not being indorsed, is inoperative and amounts to nothing, and not sending a bill of lading at all."[1]

§ 382. THE PLEDGE OF BILLS OF LADING UNINDORSED. —A bill of lading issued by a carrier on land or water is, in the United States, in the absence of statutory enactment, transferable by delivery. The effect of such delivery is to vest in the pledgee, who has made a bona fide advance, the like legal title to the property, and the right of possession, as in the case of an indorsement of the bill of lading. The pledgee takes more than the mere equitable title which passes upon the delivery unindorsed of a bill of exchange or promissory note. The bill of lading is the only evidence of ownership of his property which, after delivery to the carrier, the pledgor has. It is the voucher or acknowledgment by which the owner is enabled to show his right to the property after such delivery, and his only way to transfer such property is by indorsement and delivery, or by delivery alone, of the documents of title which he holds. A delivery of the bill of lading is generally sufficient.[2] A bill of lading,

[1] Shepherd *v.* Harrison, L. R. 4 Q. B. 204.

[2] Michigan Central R. R. Co. *v.* Phillips, 60 Ill. 198; Peters *v.* Elliott, 78 Ib. 327; Allen *v.* Williams, 12 Pick. 302 (Shaw, C. J.); Bank of Rochester *v.* Jones, 4 N. Y. 497; Marine Bank *v.* Wright, 46 Barb. 45; City Bank *v.* Rome R. R. Co. 44 N. Y. 136; Merchants' Bank *v.* Union R. R. Co. 69 Ib. 373; Becker *v.* Hallgarten, 86 N. Y. 167; Farmers' etc. Bank *v.* Logan, 74 Ib. 568; Ohio & Miss. R. R. Co. *v.* Kerr, 49 Ill. 459; DeWolf *v.* Gardner, 12 Cush. 19; Hathaway *v.* Haynes, 124 Mass. 311; National Bank *v.* Dearborn, 115 Mass. 219; Forbes *v.* Boston & L. R. R. Co. 9 Am. & E. R. R. Cas. 76; Holmes *v.* German Security Bank, 87 Pa. St. 525; The Thames, 14 Wall. 98; Dows *v.* National Exch. Bank, 91 U. S. 618; Nathan *v.* Giles, 5 Taunt. 558; Lickbarrow *v.* Mason, 1 H. Bl. 360; Meyerstein *v.* Barber, L. R. 4 H. L. 325; 2 C. P. 33.

however, although symbolical of the property represented thereby, and like the property it represents, may be transferred by delivery, is unlike commercial paper in this, that the assignee cannot acquire a better title to the property thus symbolically delivered than his assignor had at the time of the assignment.[1]

A bill of lading making the property deliverable to the consignee "or bearer," passes the title to the property described, upon delivery of such bill by the shipper to a holder for value, without notice, as against everybody but a prior assignee for value of another of the set of bills.[2] The mere insertion of the name of the consignee in the bill of lading passes no right or title to him until delivery of the bill of lading by some one authorized;[3] although the carrier may treat the consignee as the owner of the goods, until notice, either actual or presumptive, that one of the set of bills of lading is held by a pledgee or other holder for value, without notice. A delivery to such consignee, upon the production of an unindorsed bill of lading, is in the absence of such notice, a good discharge to the shipowner, or any one holding the goods, and subject to the same liabilities.[4] Even where such bill of lading is drawn "to order," a delivery thereof unindorsed is sufficient to pass the title to the property, if such be the intention of the parties to the transfer.[5]

[1] Emery *v.* National Bank, 25 Ohio St. 360; Toledo Ry. Co. *v.* Gilvin, 81 Ill. 511.

[2] Allen *v.* Williams, 12 Pick. 297; Buffington *v.* Curtis, 15 Mass. 528; Marine Bank *v.* Wright, 46 Barb. 45; Nathan *v.* Giles, 5 Taunt. 558; Meyerstein *v.* Barber, L. R 4 H. L. 325; Skilling *v.* Bollman, 73 Mo. 665; National Bank *v.* Wallbridge, 19 Ohio St. 419; Emery *v.* Irving Nat. Bank, 25 Ib. 360.

[3] Skilling *v.* Bollman, 73 Mo. 665; Allen *v.* Williams, 12 Pick. 297; Buffington *v.* Curtis, 15 Mass. 528.

[4] Stone *v.* West St. Louis Transfer Co. 9 Bradw. 48; O'Dougherty *v.* Railroad Co. 1 Thomps. & C. 477; Sweet *v.* Barney, 23 N. Y. 335; Lawrence *v.* Minturn, 17 How. 100; Glyn *v.* East & W. India Docks Co., L. R. 7 App. 591.

[5] City Bank *v.* Rome etc. Ry. Co. 44 N. Y. 186; Merchants' Bank *v.* Union R. R. Co., 69 Ib. 373; Becker *v.* Hallgarten, 86 Ib. 167; Walter *v.* Ross, 2 Wash. 283; Wiseman *v.* Vanderpat, 2 Vern. 203.

§ 383.—The Pledge of unindorsed bills of lading, as to third parties.—The pledgee for value, without notice, of a bill of lading, receiving the same by delivery unindorsed, is vested with a title to the property covered by the bill which is preferred to that of a factor or agent of the consignor to whom the goods were consigned, although the consignor be indebted to him for advances made on previous shipments.[1] And where such factor or agent has obtained possession of the goods, and sold the same, a pledgee for value of the bill of lading, who has advanced funds upon a bill of exchange drawn for the purchase money of the goods, the acceptance of which has been refused by the factor or agent, is entitled to an action as against such factor or agent, for the value of the property, or he may ratify the sale, and recover the proceeds.[2] The pledgee's title, receiving a bill of lading unindorsed, is supported as again a creditor of the pledgor who has levied an attachment upon the goods.[3] And also as against an owner of property covered by a bill of lading, who has made a sale and delivery of it to a third person, although the contract required payment before delivery. The third person, having obtained possession, and fraudulently shipped the property, received a bill of lading, which he pledged as collateral security for a bill of exchange, upon which advances were made in good faith, and without notice.[4] The claims of a pledgee for value were supported, where bona fide advances were made before the bill of lading was issued, the property being under control of the pledgee, and the latter subsequently receiving a bill of lading unindorsed.[5]

[1] Bank of Rochester *v.* Jones, 4 N. Y. 497; Emery *v.* Irving Nat. Bank, 25 Ohio St. 360, 366.

[2] Davenport Nat. Bank *v.* Homeyer, 45 Mo. 145; Allen *v.* Williams, 12 Pick. 297.

[3] Pettit *v.* First Nat. Bank, 4 Bush, 334.

[4] Michigan Central R. R. Co. *v.* Phillips, 60 Ill. 190; National Bank *v.* Dearborn, 115 Mass. 219.

[5] Becker *v.* Hallgarten, 86 N. Y. 167; Dunbrow *v.* McDonald, 5 Bosw. 130; Winne *v.* McDonald, 39 N. Y. 244; Cartwright *v.* Wilmerding, 24 Ib. 521.

§ 384.—Pledges of Bills for antecedent Debt and future Advances.—The transfer of bills of lading by the owner as collateral security for an antecedent debt, without more, constitutes the pledgee a holder for value, in the usual course of business. The negotiation of a bill of lading, with or without indorsement, passes the legal title to the property represented by it, and has the same effect as a delivery of the goods, and is in fact the only delivery which can be made of such property while in transitu; and as a pledge of personal property, with possession, for a pre-existing debt is valid, a pledge of a bill of lading, vesting constructive possession of the property in the pledgee is, under the same circumstances, equally valid.[1] As said by an English judge, "If the pledgee had said, 'I cannot take this bill of lading, as the consideration would be past; do it with the broker next door, and give me his check,' that would be valid; but is it desirable to introduce such niceties into commercial law?"[2] A pledgee of a bill of lading for an antecedent debt is supported as against a vendor's right of stoppage in transitu, and as against subsequent purchasers of the property, for value, without notice, claiming them under a duplicate bill of lading, indorsed, and with actual delivery of the goods.[3] New consideration is sufficient to support a pledge of a bill of lading for an antecedent debt, as an abandonment of threatened legal proceedings, or the surrender of other securities, etc.[4] In jurisdictions where the restricted rule prevails, the transfer of a bill of lading as collateral security for an antecedent indebtedness, without further consideration, will not constitute the indorsee a

[1] Skilling *v.* Bollman, 73 Mo. 665; Tiedman *v.* Knox, 53 Md. 612; Halsey *v.* Warden, 25 Kan. 128; Peters *v.* Elliott, 78 Ill. 325.

[2] Leask *v.* Scott, L. R. 2 Q. B. D. 376 (Bramwell, J.); overruling on this point Rodger *v.* Comptoir D'Escompte, L. R. 2 Pr. C. 405; Jewan *v.* Whitworth, L. R. 2 Eq. 692; Macnee *v.* Gorst, L. R. 4 Eq. 315; Portalis *v.* Tetley, L. R. 5 Ib. 140.

[3] Skilling *v.* Bollman, 73 Mo. 665; Peters *v.* Elliott, 78 Ill. 325; Halsey *v.* Warden, 25 Kan. 128.

[4] Leask *v.* Scott, L. R. 2 Q. B. D. 376.

holder for value so as even to preclude the vendor of the goods from exercising the right of stoppage in transitu.[1]

A pledge of bills of lading was supported upon an agreement to furnish future advances as against other pledgees chargeable with notice of such agreement when making their own advances. A shipment of goods was made by the owner, under an agreement by which the consignee had already advanced funds, and agreed to make further advances upon receiving the bills of lading as security. The legal title to the property vesting in the pledgee under the agreement, a third person, receiving another bill of lading of the same goods obtained by fraud, although before the actual delivery of the first bill to the pledgee, but who made no advances until after knowledge of the pledge of the first bill, could acquire no interest in the proceeds of the property, except as subject to the payment of the subsequent as well as the prior advances of the first pledgee.[2]

§ 385. And of Reversionary Interests in Bills of lading.—A consignee, or commission merchant, or factor who has pledged a bill of lading as security for a debt which does not exhaust the whole value of the goods, may re-pledge the same for the remainder of its value to a third person, to secure another debt. Notwithstanding the first pledge, the goods or documents of title remain in the control of the consignee or factor being in possession of another person in his behalf, to the extent to which they are not exhausted by such pledge. They are subject to redemption upon the payment of the debt, at maturity, and the principal, after such pledge and re-pledge, cannot withdraw them except upon the equitable terms of discharging the valid claims of the pledgees. Upon a notice of the re-pledge to the first pledgee, and his assent to hold any surplus of the

[1] Loeb *v.* Peters, 53 Ala. 243; Harris *v.* Smith, 17 N. Y. 249; Lessassier *v.* Southwestern R. R. Co. 2 Wood's C. C. 35.

[2] Stevens *v.* Boston R. R. Co. 8 Gray, 262.

proceeds for the benefit of the second pledgee, equity can give no relief to the principal as against the pledgees. In the event of intervening bankruptcy, the principal may prove his claim against the estate of the consignee or factor.[1]

CHAPTER XL.

THE PLEDGEE'S TITLE, AS AGAINST CARRIER.

§386. Delivery of goods essential to valid bill of lading.
387. Bill of lading valid, upon subsequent delivery.
388. Without delivery, no title acquired by innocent pledgees.
389. No recovery by pledgee, as against carrier.
390. The exceptional rule in New York, under equitable estoppel.
391. The like rule applied in Kansas and Nebraska.
392. The bill of lading, as a receipt, open to explanation.
393. Estoppel of carrier to explain receipt as against pledgees.
394. The pledgee's rights against carrier for non-delivery.
395. Notice to carrier, when required of pledgee.
396. The pledgee of the first indorsed of bills preferred.

§ 386. Delivery of Goods essential to valid Bill of Lading.—The delivery of goods represented by a bill of lading to a carrier by land or water is of essential importance to give the bill of lading validity. Without such delivery, in fact, no bill of lading, binding upon the principal, can be issued by any master of a ship or agent of an inland transportation company. The two-fold character of the bill of lading enforces the rule, as it purports to be a receipt for the property described therein, and a contract to carry and deliver the same, according to its terms. Such contract can have no existence in the absence of an actual receipt of goods. The entire bill of lading in such event is

[1] Portalis *v.* Tetley, L. R. 5 Eq. 140.

a nullity and worthless, in the hands of any holder for value. Nor is the issue of such bill of lading supported upon any rule of equitable estoppel as founded upon the acts of the shipmaster or agent of an inland transportation company, clothed with apparent authority to issue the same. Until receipt of the goods, no apparent authority arises to issue bills of lading, and no agency can exist to bind the principal. No duty or liability arises as to the shipowner or inland carrier as to property never received. It is doubtful if a transportation company could, by a vote of its stockholders or directors, issue a valid bill of lading where no goods were received by it. The result follows necessarily from the fact that bills of lading are not negotiable instruments, or representations of money; but are documents of goods, symbols of property, and their transfer as collateral security for advances is a pledge of the goods. They perform different functions from commercial paper. Inquiry may always be made as to the original transaction, and if the issue of the bill of lading is a fraud, by reason of non-delivery, no rights can be acquired thereunder by any one.[1]

§ 337.—Bill of Lading valid upon subsequent Delivery.—Where a bill of lading has been issued by a shipmaster or agent of an inland transportation company, upon a promise of immediate delivery, a delivery of the goods in accordance with such promise, will validate the bill of lading,

[1] Pollard *v.* Vinton, 105 U. S. 3; The Lady Franklin, 8 Wall. 325; The Keokuk, 9 Ib. 517, 519; Schooner Freeman *v.* Buckingham, 18 How. 182; Robinson *v.* Memphis R.R.Co. 9 Fed. Rep. 129; The Loon, 7 Blatchf. 244; The Joseph Grant, 1 Biss. 193; The Marengo, 6 McLean, 487; The Mayflower, 3 Ware, 300; King *v.* Shepherd, 3 Story, 349, 360; Stone *v.* West St Louis Transfer Co. 9 Bradw. 48; Hunt *v.* Mississippi Ry. Co. 22 La. Ann. 446; Baltimore & O.R.R.Co. *v.* Wilkins, 44 Md. 11; Tiedman *v.* Knox, 53 Ib. 612; Dean *v.* King, 22 Ohio St. 118. A bill of lading signed in blank by the master is void, even in the hands of a bona fide holder. The Joseph Grant, supra. Lickbarrow *v.* Mason, 1 Smith's L. Cas. 1205, m. p. 900; Jessel *v.* Bath, 2 Ex. 267; Brown *v.* Powell etc. Co. 10 C. P. 562; Grant *v.* Norway, 10 C. B. 665.

although there be no goods actually received at the time of its issue, and the bill of lading has been pledged as collateral security for an advance, prior to the actual delivery of the property. The receipt of the goods by the carrier has a retroactive effect, as if the delivery of the goods and the execution of the bill of lading had been concurrent acts.[1] There is no element of illegality or any such vice in the contract that it is void or incapable of confirmation by acts of the parties; and the old bill of lading is as good as a new one issued on delivery of the goods, upon the consent of the parties.[2] Nor where the issue of bills of lading, where no goods had been delivered for shipment, is made a statutory offense, with a view to prevent frauds, will the statute be so construed as to render inoperative a subsequent delivery of the goods. If this were allowed, the act itself would be made an aid to fraud.[3]

§ 388.—Without Delivery, no title acquired by innocent Pledgee for value.—The invalidity of a bill of lading issued by a shipmaster or agent of an inland transportation company, where no goods have in fact been received for carriage, affects the title of third persons acquiring interests in such bills of lading as it does the title of the immediate parties. A lender of money, although acting in good faith, and without notice of the fraud, who advances upon a bill of lading thus illegal and void, can acquire no better title than is possessed by the person from whom he receives the same as collateral. Nor is such ship-owner or inland transportation company estopped, as against such innocent person, to show the facts, as the act of the agent is absolutely void.[4] The rights of a pledgee of bills of

[1] Halliday *v.* Hamilton, 11 Wall. 560; The Idaho, 93 U. S. 575; The L. J. Farwell, 8 Biss. 61; Robinson *v.* Memphis Ry. Co. 16 Fed. Rep. 57; Rowley *v.* Bigelow, 12 Pick. 314.

[2] Robinson *v.* Memphis & C. Ry. Co. 16 Fed. Rep. 57 (Hammond, J.).

[3] The Idaho, 93 U. S. 575, 582.

[4] Pollard *v.* Vinton, 105 U. S. 5; Schooner Freeman *v.* Buckingham, 18 How. 182; The L. J. Farwell, 8

lading advancing money thereon in good faith and without notice of the fraud that no goods had been delivered, and that the bill of lading was void, were considered by the United States Supreme Court, in Schooner Freeman *v.* Buckingham,[1] the decision being characterized as "conclusive" in a late case in the same court.[2] The court say: "The taker [of a bill of lading] assumes the risk, not only of the genuineness of the signature, and of the fact that the signer was the master of the vessel, but also of the apparent authority of the master to issue the bill of lading. We say the apparent authority, because any secret instructions by the owner, inconsistent with the authority with which the master appears to be clothed, would not affect third persons. But the master of a vessel has no more apparent authority to sign bills of lading than he has to sign bills of sale of the ship. He has an apparent authority, if the ship be a general one, to sign bills of lading for cargo actually shipped; and he has also authority to sign a bill of sale of the ship when, in case of disaster, his power of sale arises. But the authority in each case arises out of and depends upon a particular state of facts. It is not an unlimited authority in one case more than in the other; and his act in either case does not bind the owner even in favor of an innocent purchaser, if the facts on which his power depended did not exist; and it is incumbent upon those who are about to change their condition upon the faith of his authority, to ascertain the existence of all the facts upon which his authority depends."

Biss. 61; The Loon, 7 Blatchf. 246; Robinson *v.* Memphis R. R. Co. 9 Fed. Rep. 129, 140; s c. 16 Ib. 57; Sears *v.* Wingate, 3 Allen, 103; Stone *v.* W. St. L. etc. Co. 9 Bradw. 48; B. & O.R.R. Co. *v.* Wilkins, 44 Md. 11; Tiedman *v.* Knox, 53 Ib. 612; National Bank *v.* Lavielle, 52 Mo. 380; Dean *v.* King, 22 Ohio St. 118; Fellows *v.* Powell, 16 La. Ann. 316; Hunt *v.* Miss. Ry. Co. 29 Ib. 446; Brown *v.* Powell etc. Co. L. R. 10 C. P. 562; Jessell *v.* Bath, L. R. 2 Ex. 267; Grant *v.* Norway, 10 C. B. 104; Hubbersty *v.* Ward, 8 Exch. 330; Coleman *v.* Riches, 16 C. B. 104.

[1] Schooner Freeman *v.* Buckingham, 18 How. 182.

[2] Pollard *v.* Vinton, 105 U. S. 5.

§ 389. No recovery by Pledgee, as against Carrier.—The rule under which, as stated, pledgees of bills of lading, fraudulently issued by agents or shipowners, without any receipt of goods, although paying value, in good faith, and without notice, can acquire no right of action as against the carrier or shipowner, was applied in the leading case of Schooner Freeman *v.* Buckingham. Two bills of lading were issued by the shipmaster, certifying that the property described had been received upon the vessel, and stating the contract of carriage and the point of delivery. These bills of lading were offered by the consignee as collateral security for an advance, and a bona fide loan was made. It subsequently appeared that no such property, as stated in the bills of lading, had ever been received on board the vessel, the issue of the bills of lading being a fraud on the part of the person having control of the ship. The pledgee libelled the boat, but as against the shipowner, no recovery was allowed.[1] Upon a shipment of cotton by railroad, a cotton merchant in New York accepted and paid a draft drawn by a buyer of cotton in Memphis, a bill of lading of the cotton being attached to the draft as collateral security. The merchant demanded the cotton of the railroad company, but it was shown that the bill of lading had been issued fraudulently by its agent, no cotton having in fact been received; and that the agent had no authority to sign bills of lading until property had been delivered by the consignor.[2] The rule as stated was applied in a case where it was sought to charge the owner of a steamboat engaged in carrying cotton from a southern port, upon a bill of lading for which no cotton had in fact been received. A bill of lading, however, had been issued, describing certain bales of cotton as being shipped upon the steamboat, to which a bill of exchange was attached and forwarded to the consignees, who, before the arrival of the steamboat, paid the draft, and received the bill of lading. Upon arrival of the

[1] Schooner Freeman *v.* Buckingham, 18 How. 182.

[2] Robinson *v.* Memphis Ry. Co. 9 Fed. Rep. 129; s. c. 16 Ib. 57.

steamboat, it appeared that no cotton, as stated in the bill of lading, had ever been delivered on the steamboat, nor on the wharf, nor to the agents of the boat. The act of issuing a bill of lading under such circumstances being clearly beyond the authority of the officer, no recovery was permitted as against the shipowner.[1]

§ 390. THE EXCEPTIONAL RULE IN NEW YORK, UNDER EQUITABLE ESTOPPEL.—Under the influence of decisions founded on the rules of equitable estoppel as applied to bona fide holders for value, without notice, of certificates of stock and other indicia of title,[2] and the consideration that the issue by a shipmaster or agent of a railroad company of a bill of lading under a general authority to issue such documents, is the act of the shipowner or company for which the latter are responsible, the courts of two or three states, including New York, have declined to follow the rule announced in Grant *v.* Norway,[3] which is generally approved both in this country and in England. Where a bill of lading, indorsed where required, is in the hands of a third person, a pledgee for value advanced on the faith of the

[1] Pollard *v.* Vinton, 105 U. S. 5.

[2] New York & N. H. R.R. Co. *v.* Schuyler, 34 N. Y. 73; McNeil v. Tenth Nat. Bank, 46 Ib. 325; Moore *v.* Metropolitan Nat. Bank, 55 Ib. 41; Griswold *v.* Haven, 25 Ib. 595; Brown *v.* Bowen, 30 Ib. 519; Shapley *v.* Abbott, 42 Ib. 443.

[3] 10 C. B. 665. In Grant *v.* Norway, a bill of lading was issued by a master of a ship for goods never received, and was pledged as collateral security for a bill of exchange on the consignees discounted by the money lender, in good faith, and without notice. Payment of the bills being refused, the pledgee sued the shipowner. No recovery, however, was allowed, as any person taking a bill of lading, even for value advanced in good faith and without notice, was chargeable with notice of the express limitation of the authority of the shipmaster that no valid bill of lading could be issued where no delivery of goods had been made. The fact that the representations of the carrier were made directly to the assignee, in Armour *v.* Railroad Co., infra, was considered as distinguishing the case from Grant *v.* Norway, where the assignee simply acquired the title of the fraudulent consignee. In such case, the assignee of a chose in action takes no better title than that of the person from whom he buys. Griswold *v.* Haven, 25 N. Y. 604, 606.

representations stated in the bill of lading, without notice of equities, the carrier is not permitted to set up any fraud of the shipper, or the non-delivery of the goods, or even forgery in the original transaction, where the bill of lading is not itself tainted with forgery. The decisions are founded upon the rule of estoppel by conduct, applied as well to corporations as individuals, that where one of two innocent persons must suffer by the fraud or deceit of a third, the loss should fall upon the one who has enabled the third person to commit the fraud or deceit.[1]

The rule was applied in a case in New York where an agent of a railroad company issued two bills of lading deliverable to the order of A, the consignee, the agent being informed at the time of delivery, that it was the intention of the person to use them at a bank. This was done, a bank advancing money to the shipper, upon discount of drafts drawn upon the consignee, the bills of lading being attached. Upon presentation to the consignees, the drafts were paid upon the faith and credit that the property had been shipped as stated in the bills of lading. In fact, no goods had been delivered at the time of issuing the bills of lading, although a warehouse receipt for them was handed to the agent. The warehouse receipt, however, was a forgery, and the shipper had no property such as was pretended to be specified by such receipt. The act of the agent in issuing the bills of lading, being within his apparent authority, the railroad company were estopped as against an innocent person advancing value on the credit of the representations contained in the bill, to set up the fraud, and the plaintiffs, the consignees, were allowed to recover.[2] In another, and later case, a bill of lading was issued by a railroad agent, stating that the goods described were shipped by A, and

[1] Hern *v.* Nichols, 1 Salk. 289; Savings Bank *v.* Railroad Co. 20 Kan. 529; Armour *v.* Mich. Cen. R. R. Co. 65 N. Y. 111; Farmers' and Mechanics' Bank *v.* Erie Ry. Co. 72 Ib. 189; Sioux City Bank *v.* First Nat. Bank, 10 Neb. 556.

[2] Armour *v.* Michigan Cen. R. R. Co. 65 N. Y. 111.

were to be delivered to the order of a bank, the plaintiff. Upon presentation of the bill of lading, the bank advanced money thereon in good faith, and upon the arrival of the goods at their destination, caused their sale, and re-imbursed itself for its advances. It appeared that the property was not owned by A, but by B, who had already obtained a loan upon the credit of the goods, before A obtained possession of them, and misappropriated them. The first pledgee recovered the value of the property from the second pledgee,[1] who then brought an action against the railroad company. Applying the rule that a company is responsible for the wrongful torts and negligence of its agents, the railroad company was required to pay the pledgee the full value of the property, as the agent was chargeable with knowledge that A was not the owner of, nor a purchaser of the goods.[2]

§ 391. The like Rule applied in Kansas and Nebraska. — The rules of equitable estoppel were also enforced as against a railroad company in favor of a bona fide pledgee for value, without notice, in a case in Kansas, where an agent, having authority to issue bills of lading, was induced by fraudulent statements of the consignor to issue first one, and then a second bill of lading, both purporting to be originals. One of the bills was sold to a bona fide purchaser for value, who subsequently obtained the goods. The other, issued shortly afterwards, was deposited as collateral security with a bank for an advance of money made upon the faith of the representations contained in the bill of lading, in good faith, and without notice. Evidence was given to show a custom of railroads to issue but one bill of lading, and the bill offered as collateral security purporting to be an original, the carrier was estopped to dispute its terms as to the receipt of the property. The pledgee was

[1] Manufacturers' Bank *v.* Farmers' Bank, 60 N. Y. 40.

[2] Farmers' Bank *v.* Erie Ry. Co. 72, N. Y. 189.

allowed to recover from the railroad company the amount of his advances.[1]

In another case, in Nebraska, where bills of lading were issued by an agent of a railroad company, for several carloads of grain which were never shipped, and the bills, with other bills for actual shipments, were attached as collateral security for the payment of drafts discounted by a bank for the full value of such supposed shipments, and forwarded for payment. The drafts being protested, and the shipper having absconded leaving no property, the railroad company was estopped to deny the representations on the bills of lading, made by its authorized agent, as against a bona fide pledgee, holding the same for value advanced upon the credit of such representations, and without notice of the fraud or other equities.[2]

§ 392. The Bill of Lading, as a Receipt, open to explanation.—A bill of lading is both a contract and a receipt. As a contract, it is an agreement safely to carry the property; as a receipt, it is a representation that the goods have been received, and of their apparent condition.[3] If the shipment be made by vessel, and as usual in such cases the bill of lading is issued in a set of three, one being retained by the shipmaster, the actual contract, in case of dispute, is gathered from the bills of lading delivered by the shipmaster to the consignor. The ship's bill is designed only for the information and convenience of the master; and not for evidence between the parties of what the agreement is. Should it differ from the others, the latter are considered as the true and only evidence of the contract.[4] So far as a bill of lading is a receipt, and as between the original parties, it is always open to explanation,

[1] Wichita Savings Bank *v.* Railroad Co. 20 Kan. 529.

[2] Sioux City Nat. Bank *v.* First Nat. Bank, 10 Neb. 556.

[3] Pollard *v.* Vinton, 105 U. S. 3, 8; Relyea *v.* N. H. Rolling Mill Co. 42 Conn. 577.

[4] The Thames, 14 Wall. 98.

and any mistake or fraud in the statement of the goods shipped may be shown by parol proof.[1]

In England, under the act now in force, the statements contained in bills of lading relating to the goods are conclusive evidence of such shipments, where the bill is in the hands of a consignee or indorsee for valuable consideration, unless the holder of the bill has actual notice, at the time of receiving the same that the goods had not been in fact laden on board, or that such misrepresentation is caused without default on the part of the shipmaster, and wholly by the fraud of the shipper, or of the holder, or some person under whom the holder claims. But even under this act it may be shown that the cargo actually received differs in weight from that signed for in the bill of lading, where the weight mentioned is mere matter of measurement.[2]

§ 393.—Estoppel of Carrier to explain receipt, as against bona fide Pledgee for value.—The rule permitting an explanation of so much of a bill of lading as is a receipt is not enforced as against a consignee, who is not a party to the contract, nor an indorsee of a bill of lading, holding the same in good faith as collateral security for an advance made upon the faith of the representations on the the face of the bill. The shipowner or inland transportation company is estopped to deny the truth of the statements in the bill of lading to which credit has been given,

[1] Sears *v.* Wingate, 3 Allen, 103; Portland Bank *v.* Stubbs, 6 Mass. 422; Ellis *v.* Willard, 9 N. Y. 529; Meyer *v.* Peck, 28 Ib. 590; Dickerson *v.* Seelye, 12 Barb. 102; Hunt *v.* Mississippi Central Ry. Co. 29 La. Ann. 446; O'Brien *v.* Gilchrist, 34 Me. 554; Dean *v.* King, 22 Ohio St. 118; Relyea *v.* N. H. Rolling Mill Co. 42 Conn. 577; Bates *v.* Todd, 1 M. & Rob. 106; In re Brown, 1 Biss. 76; Bradstreet *v.* Heran, 2 Blatchf. 116; Sutton *v.* Kettell, Sprague's Dec. 309; Schooner Freeman *v.* Buckingham, 18 How. 182; Pollard *v.* Vinton, 105 U. S. 3; Berkeley *v.* Watling, 7 Ad. & E. 29; Howard *v.* Tucker, 1 B. & Ad. 712.

[2] Bills of Lading Act, 18 and 19 Vict. c. 111, s. 3; Blanchett *v.* Powell's Co. L. R. 9 Ex. 74; McLean *v.* Fleming, L. R. 2 H. L. Sc. 128; Brown *v.* Powell Coal Co. L. R. 10 C. P. 562; Carr *v.* London & N. W. Ry. Co. L. R. 10 C. P. 307.

so far as such matters are or ought to be within the knowledge of the officers issuing such bills of lading.[1] The issue of a bill of lading acknowledging the receipt of a certain quantity of merchandise, enables the shipper to go upon the market and obtain money, either upon the deposit of such bills of lading as collateral security for an advance, or as the purchase price of the property purporting to be represented thereby. As against a bona fide pledgee, for money advanced, in the usual course of business, and without notice, the want of care of the shipmaster or carrier in issuing a receipt in such bill of lading for an amount of goods exceeding that actually received, forms no defense to an action for the wrong.[2]

The rule mentioned as to the limitations to which explanations by a carrier of statements contained in his bill of lading are subject, was enforced in another case, where the owner and master of a vessel signed a bill of lading for a certain quantity of iron, upon a representation of the shippers that the weight was correct. The bill of lading was attached to a draft, and both sent to the consignees, who remitted the amount of the bill after the arrival of the ship, but before the cargo was discharged. It was found afterwards that the iron was short several tons of the amount called for, and payment of freight was refused. The owner of the ship was estopped by his representations in the bill of lading, and in a suit for the freight the consignees were allowed to set off the amount of their loss, not exceeding the aggregate of their particular claim. The terms of the bill of lading were not open to explanation as against a deceived consignee, as it was the duty of the master to ascertain the true weight, or to refuse to sign a clear bill of

[1] Dickerson *v.* Seelye, 12 Barb. 102; Sears *v.* Wingate, 3 Allen, 103; Dows *v.* Perrin, 16 N. Y. 325; Meyer *v.* Peck, 28 Ib. 590; Bates *v.* Todd, 1. M. & Rob. 106; Dean *v.* King 22 Ohio St. 118; Relyea *v.* N. H. Rolling Mill Co. supra; Bradstreet *v.* Heran, 2 Blatchf. 116. And an action against the master issuing such receipt may be maintained. Tindall *v.* Taylor, 4 El. & Bl. 210.

[2] Meyer *v.* Peck, 28 N. Y. 590.

lading, and he knew or had the means of knowing the statements were false.[1]

§ 394.—The Pledgee's rights against Carrier for non-delivery.—A bill of lading although not possessing all the attributes of a negotiable instrument, is a representative of the property described therein, and its delivery to a pledgee, upon a bona fide advance, in the usual course of business, places such property under his control, to the same extent as if the same were actually delivered. Holding the legal title and right of possession, the pledgee of a bill of lading by indorsement and delivery, where indorsement is required, or by delivery, is entitled to bring an action in his own name against a carrier, who has undertaken the carriage of such property, for non-delivery, in whole or in part, or for loss or damage to the goods,or for delivery without the production of the bill of lading, or any other action based upon the right of possession.[2] Where there has been a total non-delivery of the property, the pledgee of the bill of lading may sue the carrier in an action of trover for a wrongful conversion, after a proper demand for the goods.[3] A bill of lading remains in full force until the engagement of the carrier has been completely fulfilled by a delivery of the property to some person, having the right to claim

[1] Relyea *v.* N. H. Rolling Mill Co. 42 Conn. 577; Bradstreet *v.* Heran, 2 Blatchf. 116; Sears *v.* Wingate, 3 Allen, 103.

[2] Robinson *v.* Memphis etc. Ry. Co. 9 Fed. Rep. 129, 141; s. c. 16 Ib. 57; The Thames, 14 Wall. 98; s. c. 7 Blatchf. 226; The Vaughan, 14 Wall. 258; Pollard *v.* Vinton, 105 U. S. 7; Forbes *v* Boston & L. Ry. Co. 133 Mass. 154; Newcomb *v.* Boston etc. Ry. Co. 115 Mass. 230; Merchants' Bank *v.* Miss. R. Co. 69 N. Y. 373; First Nat. Bank *v.* Northern Ry. Co. 58 N. H. 203.

[3] Maguire *v.* Dinsmore, 70 N. Y. 410; Viner *v.* N. Y. etc. Ry. Co. 50 Ib. 23; Hawkins *v.* Hoffman, 6 Hill, 586; Wright *v.* Northern Cent. Ry. Co. 8 Phila. 19; Winslow *v.* Vermont Ry. Co. 42 Vt. 700; Forbes *v.* Boston & L. Ry. Co. 133 Mass. 154, 158; Rosenfield *v.* Express Co. 1 Woods, 131; The Thames, 14 Wall. 98; Southern Exp. Co. *v.* Dickson, 94 U. S. 549.

delivery and possession.[1] Where bills of lading issued by the shipmaster state that the goods are shipped by a certain firm, to be delivered "to order or assigns," delivery to any one who has not the order of the shipper is not a good delivery.[2] A custom, however, was allowed to be proved, where railroad companies issued bills of lading deliverable to a named person, and not "to order, or assigns," to deliver the goods to the consignee without production of the bill of lading, but merely upon the direction of the way-bill. A bill of lading, thus worded, was pledged upon an advance, made in good faith, but upon demand for the goods, it was found the company had already delivered them to the person named in the way-bill. The pledgee's action of trover against the company, in view of the custom proved, was not sustained.[3]

Where valid legal process has been issued from a court having jurisdiction of the carrier, demanding delivery of property in its possession, a delivery to the officer who presents the writ, operates as a discharge of the carrier, provided immediate or at least reasonable notice of the attachment or execution is given to the consignee or other person entitled to delivery.[4] Carriers, or their agents are required to act in good faith, for if there be any collusion or fraud, they are bound to establish the title of the adverse claimant to be better than that of the pledgee or other holder for value of the bill of lading. Money was advanced in good faith by a consignee upon a bill of lading forwarded to him, but after delivery of the goods to the carrier, and when about to be shipped, a claimant, under an order

[1] Barber *v.* Meyerstein, L. R. 2 C. P. 38 (Willes and Keating J. J.), s. c. L. R. 4 H. L. 332 (Hatherley, Lord Chan.); Glyn *v.* E. & W. India Docks Co. L. R. 7 App. 600.

[2] The Thames, 14 Wall. 98.

[3] Forbes *v.* Boston & L. Ry. Co. 133 Mass. 154.

[4] Robinson *v.* Memphis & C. Ry. Co. 16 Fed. Rep. 57; Stiles *v.* Davis, 1 Black. 101; Rosenfield *v.* Express Co. 1 Woods, 131; Burton *v.* Wilkinson, 18 Vt. 187; Ohio & Miss. R.R. Co. *v.* Yohe, 51 Ind. 181; Bliven *v.* Hudson River R. Co. 36 N. Y. 403; Kiff *v.* Old Colony R.R. Co. 117 Mass. 591.

from the consignor who had fraudulently re-assigned the property as security for an overdrawn account, demanded the goods. The agent refused to deliver, but acting upon a promise made to such claimant, delayed shipment until legal process could be served. The consignee recovered from the carrier the value of the property thus illegally detained, to the full amount of his advances.[1]

§ 395. Notice to Carrier when required of Pledgee.—A pledgee for value of a bill of lading, holding the legal title to the property as though an actual delivery had been made, is not bound by any strict rules of notice of his interest or claim to carriers, or other persons dealing with the goods; nor is he required upon the arrival of the goods at their destination to proceed immediately to take possession of the same. It is no excuse for a wrong delivery by a carrier that the pledgee of a bill of lading, holding under indorsement, is unknown to the carrier, and that notice of the arrival of the goods cannot apparently be sent to him. If, after diligent inquiry, such pledgee and indorsee cannot be found, then the carrier is required to hold the goods until claimed, or to store them for their owner. Delivery to a stranger under any circumstances is not a discharge of the carrier.[2] Nor is a pledgee for value of a bill of lading, indorsed and delivered, required to give notice to any warehouseman or wharfinger to whom the property represented by such bill, has been delivered, under a stop for freight. He is under no obligation to give notice to anyone.[3] A delay of nearly two months by a pledgee for value of a bill of lading, indorsed and delivered, in giving notice of his interest and claiming possession of the goods, will not constitute *laches* so as to defeat his legal title, although in

[1] Robinson *v.* R. R. Co., 16 Fed. R. 57.

[2] The Thames, 14 Wall. 98; Forbes *v.* Boston & L. Ry. Co, 133 Mass. 154; s. c. 9 Am. & E. R. R. Cas. 76; Farmer's Bank *v.* Logan, 74 N. Y. 568; Barber *v.* Meyerstein, L. R. 4 H. L. 317; Glyn *v.* E. & W. India Docks Co. L. R. 7 App. 605.

[3] Barber *v.* Meyerstein, L. R. 4 H. L. 337 (Westbury, Lord Chan).

the meantime the consignee who had pledged the bill of lading, obtained the goods from the carrier, upon the false representation that he held the bill of lading, and shipped them abroad. The pledgee was allowed to recover from the carrier the market value of the goods at the time of the conversion, less the freight, with interest.[1]

A bona fide pledgee, advancing money upon the indorsement and delivery of a bill of lading which shows upon its face that it is issued in a set of bills of more parts than one should require all the bills of the set except the shipmaster's bill, to be produced, indorsed and delivered, before making an advance, for the reason that other of the series may already have been indorsed and delivered for value advanced in good faith. Possession of two of a set of three bills of lading, being the first and second, was considered sufficient in the leading cases of The Thames and Barber *v.* Meyerstein, the fraud being committed in each case by the use of the third or shipmaster's bill as collateral security for advances. Where money is advanced upon one only of a set of three bills of lading it is advisable for the pledgee to be on the alert so that he may give notice of his claims to the shipmaster upon the arrival of the vessel.[2] The pledgee holding indorsed the "first" only of a set of three bills of lading upon a bona fide advance to the consignee, "one of which bills being accomplished, the others to stand void," is not entitled, under the latest decision of the English House of Lords, to recover any damages from the shipowner or wharfinger where, before notice of his claims, or any knowledge of the negotiation for value of other bills of the set, a bona fide delivery of the property is made upon the "second" bill, presented by the consignee, unindorsed, the property being deliverable by the bills of lading to him "or assigns."[3]

[1] Forbes *v.* Boston & L. Ry. Co. 133 Mass. 154.

[2] Glyn *v.* E. & W. India Docks Co. L. R. 7 App. 600, 605.

[3] Glyn *v.* E. & W. India Docks Co. L. R. 6 Q. B. D. 504; s. c. L. R. 7 App. 600, 612, 615; Meyerstein *v.* Barber, L. R. 4 H. L. 317 (Lord Westbury). Criticising earlier cases, in which, notwithstanding notice to

The rule announced, however, is declared, in a later case, not to limit the recognized effect, as against all parties, except the shipowner, acting in good faith, of an indorsement of a bill of lading to a holder for value, without notice.[1]

§ 396. THE PLEDGEE OF THE FIRST INDORSED OF BILLS PREFERRED.—The utility of continuing the usage of issuing bills of lading in sets of three or more, which had its particular value before electricity, giving almost instant communication with all parts of the world, was utilized, is questionable. Much litigation would be avoided, and fraudulent dealings prevented, if only one bill of lading should be used, nor would the interests of commerce be restricted thereby.[2] As between two bona fide pledgees each receiving a bill of lading of the set of three, "one of the bills being accomplished, the others to stand void," the third being retained by the shipmaster as the "ship's bill," the pledgee who is first in time in receiving one of the set properly indorsed,

the shipmaster of the true title, he was allowed, in case of dispute between rival claimants, to deliver to the one he thought entitled, and by this would be fully discharged. Fearon *v.* Bowers, 1 H. Bl. 364; s. c. 1 Sm. L. Cas. 8th Ed. 782; Lickbarrow *v.* Mason, 1 H. Bl. 357; The Tigress, Br. and L. Adm. 38; 32 L. J. (P. and A.) 97.

[1] Sanders *v.* Maclean, L. R. 11 Q. B. D. 327. As said by the Court of Appeal: "The property in the goods passes by the indorsement and delivery of the bill of lading, whenever it is the intention of the parties that the property should pass, just as under similar circumstances, the property would pass by an actual delivery of the goods. And for the purpose of passing such property in the goods and completing the title of the indorsee to full possession thereof, the bill of lading, until complete delivery of the cargo has been made on shore to some one rightfully claiming under it, remains in force as a symbol, and carries with it not only the full ownership of the goods, but also all rights created by the contract of carriage between the shipper and the shipowner. It is a key which in the hands of a rightful owner is intended to unlock the door of the warehouse, floating or fixed, in which the goods may chance to be." (Bowen, L. J.)

[2] Glyn, Mills & Co. *v.* E. & W. India Docks Co. L. R. 7 App. 605 (Earl Cairns and Lord Blackburn); Sanders *v.* Maclean, L. R. 11 Q. B. D. 327.

and upon a valuable advance, is preferred, although the pledgee receiving the second of the series has advanced value thereon, in good faith, without notice of the previous hypothecation.[1] Nor is the pledgee who is prior in time, having both the right of property and possession required to give notice to the shipowner of his title and right to possession, but may, if the goods are obtained and sold upon another of the set of bills of lading negotiated subsequently to his own, bring an action against the second pledgee, either for the proceeds of the goods as for money had and received for his use, waiving the tort, or for a wrongful conversion.[2] The tender of one of a set of three bills of lading, duly indorsed, is an effectual tender of the goods, although the others be not produced. Where, by the terms of the contract, payment is to be made of bills of exchange upon delivery of bills of lading attached as collateral security, upon presentation, the purchaser who refuses to accept and pay, upon the presentation of a duly indorsed bill of lading, does so at his own risk as to whether it may turn out to be the fact or not that the bill of lading tendered was an effectual one, or whether therewas another of the set which had been so dealt with as to defeat the title of the purchaser as indorsee of the one tendered.[3]

[1] Barber *v.* Meyerstein, L. R. 4 H. L. 337; The Thames, 14 Wall. 98. In which cases the respective pledgees received two of the set of three bills of lading, believing the "ship's bill" to be in possession of the master, but delivery was in fact obtained upon the third bill. The first two of the set were delivered in Skilling *v.* Bollman, 73 Mo. 665; but one was stolen by a partner of the firm, and negotiated, and the contest was as to priority. The court approves the rule of Meyerstein *v.* Barber. In Glyn *v.* E. & W. India Docks Co. L. R. 7 App. 605, the English House of Lords, while refusing to sustain an action of trover by a pledgee of the "first" of a set of bills of lading as against a shipowner or wharfinger delivering to the consignee on the "second," unindorsed, say (Blackburn, Lord) that "so far as the decision in Barber *v.* Meyerstein extends, the law must be taken to be settled," and another law lord (Fitzgerald) said there was no intention "to modify or depart from" the decision mentioned.

[2] Barber *v.* Meyerstein, and The Thames, supra.

[3] Sanders *v.* Maclean, L. R. 11 Q. B. D. 327. In the Court of Appeal of the Queen's Bench (Bowen, L.

CHAPTER XLIX.

THE PLEDGEE'S RIGHTS, UNDER ESTOPPEL.

§397. Estoppel as applied to bills of lading negotiable or quasi-negotiable.
398. Estoppel of owner, where third person holds bill indorsed.
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§ 397.—ESTOPPEL AS APPLIED TO BILLS OF LADING NEGOTIABLE, OR QUASI-NEGOTIABLE.—In countries and states where bills of lading are made negotiable by statute, they are in the hands of third persons loaning money upon them in good faith, without notice, as free of antecedent equities as bills of exchange or negotiable promissory notes. The holder of an indorsed bill of lading, where negotiable, may, in the course of commercial dealing, transfer a greater right than he himself has, the exception being founded on the negotiable character of the document. It is confined to the cases where the person who transfers the right is himself in

J.), referring to the rule that the first indorsee of bills is entitled to the property, as against everybody but the shipowner, said: "People who lend money upon or who purchase bills of lading can make their own terms. Whether they will trust to the current bills of lading produced in any case is a matter for themselves, and one upon which they probably would be guided by their faith in or distrust of their customer. But I do not believe that such suspicion, when it exists, is the natural or necessary consequence of the presentation of the two bills without the third."

actual and authorized possession of the document, and the transferee gives value on the face of it, without having notice of any circumstances which would render the transaction neither fair nor honest. In such case, one of two innocent parties must suffer by the act of a third; and it is reasonable that he who, by misplaced confidence, has enabled such third person to occasion the loss, should sustain it.[1] The rules of equitable estoppel are applied in favor of pledgees of bills of lading indorsed who have advanced money on bills sent by the vendor to the vendee and consignee, as against the right of stoppage in transitu of the unpaid vendor, if at the time of making the advance the pledgee is without notice of any cause upon which such right might arise.[2]

The rules of equitable estoppel are applied in cases where bills of lading, while not negotiable, are quasi-negotiable, under indorsement for value. A transfer of a bill of lading, by indorsement where required or by delivery, vests the legal title to the property and the right to possession in a pledgee for value advanced in good faith, without notice of equities. The pledgee may rely upon the possession and apparent ownership of a holder of a bill of lading, where the same is received in the usual course of business. As where a vendor has allowed a vendee to assume possession and apparent ownership of bills of lading, so as to be able to deal with them as his own, third persons may rely upon such possession and apparent ownership of the *indicia* of title. The vendor is estopped to dispute such title as against persons innocently making advances in the belief that the apparent title is the real title and the ownership

[1] Rodger *v.* Comptoir D'Escompte, L. R. 2 Pr. C. 393, 405 (Sir Joseph Napier); The Argentina, L. R. 1 A. and E. 370; Gurney *v.* Behrend, 3 El. and Bl. 622; Lickbarrow *v.* Mason, 2 Term, 70.

[2] Spalding *v.* Ruding, 6 Beav. 376; In re Westzinthus, 5 B. & Ad. 817; Berndtson *v.* Strang, L. R. 4 Eq. 486; on app. L. R. 4 Ch. 588; Coventry *v.* Gladstone, L. R. 6 Eq. 44; ex parte Golding, L. R. 13 Ch. D. 624; Kemp *v.* Falk, L. R. 14 Ch. D. 446; on app. L. R. 7 App. 573.

absolute.[1] No secret agreement between a vendor and vendee in relation to the obtaining and use of bills of lading can affect the title of a bona fide pledgee, who has made an advance of money upon such bills of lading, without notice.[2] The rules of equitable estoppel applied in cases where the bill of lading is negotiable, is also invoked in favor of the innocent pledgee for value, where the bill of lading is rather quasi-negotiable than actually so, that where one of two innocent parties must suffer from the wrongful acts of a third person, the law casts the burden or loss upon him by whose act, omission, or neglect, such third party was enabled to do the wrong, or occasion the loss.[3]

§ 398.—Estoppel of Owner, where third person holds Bill indorsed.—The owner of property, represented by a bill of lading, may, by his affirmative acts or neglects, in and about such bill of lading, estop himself to set up any defenses or equities as against an innocent holder for value. Where a bill of lading is delivered indorsed by the owner to a third person so as to vest the legal title and apparent ownership in the holder, and an innocent pledgee is deceived into advancing money upon the faith and credit of such title and apparent ownership, and a loss results, it is placed upon the owner who, with mistaken confidence, has placed an indorsed bill of lading in the hands of another, thus enabling the latter to deal with it as if he were the

[1] Dows *v.* Kidder, 84 N. Y. 121; Saltus *v.* Everett, 20 Wend. 267; Fleeman *v.* McKean, 25 Barb. 474; Beavers *v.* Lane, 6 Duer, 238; Smith *v.* Lynes, 5 N. Y. 41; Crocker *v.* Crocker, 31 Ib. 507; Wait *v.* Green, 36 Ib. 556; Paddon *v.* Taylor, 44 Ib. 371; Rawles *v.* Deshler, 42 N. Y. 572; Comper *v.* Coningham, 77 Ib. 391.

[2] Western Union R. R. Co. *v.* Wagner, 65 Ill. 197; Wait *v.* Greene, 35 N. Y. 556; Wyne *v.* Macdonald, 39 Ib. 233.

[3] Savings Bank *v.* Railroad Co. 20 Kan. 519; In re Brown, 1 Biss. 76; Bradstreet *v.* Heran, 2 Blatchf. 116; Michael *v.* Ware, 3 Neb. 229; Relyea *v.* N. H. Railway Co. 42 Conn. 579; Armour *v.* Michigan Cent. R.R. Co. 65 N. Y. 111; Rowles *v.* Deshler, 42 Ib. 572; Carr *v.* London Ry. Co. L. R. 10 C. P. 307; Lickbarrow *v.* Mason, 2 Term, 63.

actual owner.[1] The title of a bona fide pledgee for value, without notice, of a bill of lading, was recognized in the case of the Farmers and Mechanics' Bank *v.* Hazeltine, in the New York Court of Appeals,[2] arising out of the frauds committed by an agent named Brown, and in which, and in other cases, the rights of pledgees as against persons dealing in an unauthorized manner with property shipped under bills of lading bearing restrictive indorsements, were adjudicated. In all of these cases, the court (Andrews, J.) say: "The court did not question the well established doctrine that a general indorsement and delivery of a bill of lading vests in the indorsee the title to the bill, and the property thereby represented, so as to enable him to transfer to a bona fide purchaser, for value, a good title, whatever secret arrangement may have existed between the original parties;" and that if the delivery under the bill of lading had "vested the title to the property in Brown, and the trust contained in the instrument was a trust affecting the proceeds to be realized from a sale, then, upon well-settled principles, a bona fide purchaser from Brown would acquire a good title which would not be divested or disturbed by a misappropriation by Brown of the proceeds of the sale in contravention of the trust."

The possession of property by a broker or agent, upon which is obtained from the carrier when shipping the goods to his principal, a bill of lading deliverable to his own order, enables such broker or agent to bind the owner by a transfer of the bill of lading to a pledgee to secure an advance, when made on the faith of such indicia of title, and without notice of equities, as that the principal had already paid for the goods,[3] or that the indorsement and transfer of the bill of lading was procured by a fraudulent misrepresentation.[4] The rights of bona fide pledgees of bills of lading

[1] Gurney *v.* Behrend, 3 El. & Bl. 622; The Argentina, L. R. 1 A. & E. 370.

[2] 78 N. Y. 104, 108.

[3] Henry *v.* Philadelphia Warehouse Co. 81 Pa. St. 76.

[4] Dows *v.* Greene, 24 N. Y. 638.

indorsed, receiving the same as collateral security for advances, without notice of equities, were sustained as against a consignor in one case and a shipowner in another, where the same were drawn and indorsed in fraud of the consignor and shipowner.[1] A vendor obtained discount of bills of exchange drawn against a consignment, and attached bills of lading as collateral security, the pledgee agreeing to give up the bills of lading upon receipt of satisfactory acceptances of the bills of exchange, or upon failure, to sell the goods and apply the proceeds to the payment of the bills. The proceeds of a sale of the bills of lading were misappropriated by a broker to whom they had been entrusted. The pledgee sued the parties upon the bills of exchange, and was allowed to recover, the misappropriation by the broker constituting no defense.[2]

§ 399. The Pledge of void or fraudulent Bills of lading.—The rules of estoppel in pais were enforced in Armour *v.* Michigan Central Railroad Company,[3] decided by the New York Court of Appeals. In that case, an agent of the railroad company issued, upon the delivery of a forged warehouse receipt, two bills of lading, acknowledging the receipt of property, consigned to the plaintiff at New York. Advances were made upon bills of exchange drawn against the fictitious shipment, the bills of lading being attached as security, and the plaintiff paid the same upon presentation, on the faith and credit of the railroad bills of lading. No merchandise was in fact ever shipped. Suit was brought by the holder of the bills of lading against the company. As the acts of the agent were within the apparent scope of his authority, an estoppel arose against the company to deny the receipt of the property, and it was required to pay the plaintiff damages. A bill of exchange, drawn upon A by a foreign correspondent, with bills of lading attached,

[1] Gabarron *v.* Kreeft, L. R. 10 Ex. 274; Kreeft *v.* Thompson, Ib. 274, 282.

[2] Magoun *v.* Sinclair, 66 N. Y. 30.

[3] 65 N. Y. 111.

was sent to a banker for collection, who presented the bill of exchange for acceptance with the memorandum, "The bank holds bill of lading and policy for 251 bales of cotton, per William Cummings." The plaintiff accepted the bill and afterwards paid the money, but the bill of lading proved to be a forgery. An action was brought to recover the money, but as the memorandum of the bank did not amount to a representation that the bill of lading was genuine, nor to a guaranty of its validity, the plaintiff had no equity to recover the money.[1] A bill of lading, fraudulent or fictitious, or simply evidence to establish a criminal offense, is void as a security for an advance, irrespective of the knowledge or want of knowledge of the indorsee.[2] Such indorsee of a fictitious bill of lading, or of one fraudulently transferred, has no remedy against an indorser, unless for special wrong.[3]

§ 400. Application of Estoppel, as between successive Pledgees.—The rule that in order to create an estoppel as against an owner of property, which has come, through the fraudulent acts of a third person, into the hands of a bona fide purchaser for value, the former must have enabled the wrongdoer to commit the fraud, and that a tortious act of a third person, to which the owner was not a party, and in no way aided, will not defeat his title to the property, is applied in favor of a pledgee of bills of lading as against subsequent pledgees. The rule was applied in favor of a pledgee of a bill of lading indorsed, upon the security of which a note was discounted, as against a pledgee of bills of lading, falsely issued, upon which no goods were delivered, as security for drafts accepted and paid for the

[1] Leather *v.* Simpson, L. R. 11 Eq. 398; Robinson *v.* Reynolds, 2 Q. B. 196, 202.

[2] Bassett *v.* Spofford, 45 N. Y. 587; Brower *v.* Peabody, 13 Ib. 121; Saltus *v.* Everett, 20 Wend. 267; Schooner Freeman *v.* Buckingham, 18 How. 182; Grant *v.* Norway, 10 C. B. 665.

[3] Maybee *v.* Tregent, 47 Mich. 495.

pledgor and general owner. The pledgor, without the knowledge of the first pledgee, caused the property represented by the genuine bill of lading to be shipped and delivered to the pledgees holding such fictitious bills, who upon demand refused to surrender it to the first pledgee, and afterwards sold the same. The first pledgee, having a special ownership in and possession of the property, any dominion exercised over the same by the general owner without his consent, was tortious, and transferred no title.[1] As the pledgee had not clothed the general owner with any apparent title or authority to dispose of the property, or in any way aided in the fraud practiced on the second pledgees, no estoppel arose as against him to reclaim his property.[2] A like rule was applied in favor of a pledgee of a bill of lading, where through the fraudulent conduct of a proposed vendee of the property from its agent, holding under a restricted title, a second bill of lading for the same property was obtained from a railroad company, under which the goods were sold by a pledgee.[3] Subsequently, the pledgee of the second bill, having paid the judgment, was allowed to recoup itself in a suit against the railroad company.[4]

§ 401. The Pledge of Bills of lading upon fraudulent Shipments. — The use of bills of lading, with or without indorsement, as collateral security for loans or discounts of commercial paper, places the pledgee in possession of the property described in the bills, as if the same were actually delivered to him. The bill of lading, whether issued by a shipmaster or by an agent of a railroad company, is the only evidence of title and ownership of the goods shipped, after delivery to the carrier, that the owner has; it

[1] Marine Bank *v.* Fiske, 71 N. Y. 353; State Bank *v.* Jones, 4 N. Y. 497; Dows *v.* Nat. Bank, 91 U. S. 618; Jenkyns *v.* Brown 14 Q. B. 496.

[2] Marine Bank *v.* Fiske, supra; Barnard *v.* Campbell, 55 N. Y. 456, 462.

[3] Mechanics' Bank *v.* Farmers' Bank, 60 N. Y. 40.

[4] Farmers' Bank *v.* Erie R.R. Co. 72 N. Y. 188.

is a voucher, issued by the carrier, whether by land or water, that, upon payment of freight the goods will be delivered to the owner of the bill of lading, or to his assigns. The bill, as a symbol of property, is not a promise to pay money, nor a representative of money, and the holder is not charged with the duties of the indorsee of commercial paper. The title acquired by the pledgee by indorsement of a bill of lading is that of the indorser; or such rights as the original holder of the bill of lading had.[1] Where a bill of lading is obtained by a person from a carrier for goods which are not his property, or which he has no authority from the owner to ship, or for which he has not paid the purchase price, as agreed, neither the holder of such bill nor his transferee, though he be an innocent pledgee for value, without notice, can acquire any rights or title as against the true owner, unless the latter is within some of the recognized rules of estoppel in pais.[2]

§ 402. And where Pledgee has Notice of prior Equities.—The title of the owner of property is not defeated as to third parties who have made advances on bills of lading representing such property in good faith and without notice of an agreement that payment should be made before the title to the property should pass, where the vendor has notified the pledgee of his claim to the property, and the pledgee, although the property has been sold, still retains in his hands funds of the fraudulent vendee sufficient to repay the vendor. Such proceeds are regarded as taking the place of the prop-

[1] Canadian Bank *v.* McCrea, 106 Ill. 281; Forbes *v.* Boston & L. R.R. Co. 133 Mass. 154; Farmers' Bank *v.* Logan, 74 N. Y. 568; Saltus *v.* Everett, 20 Wend. 269; Burton *v.* Curyea, 40 Ill. 320; Hunt *v.* Miss. Central Ry. Co. 29 La. Ann. 446; Fellows *v.* Powell, 16 Ib. 316; Evansville etc. R. R. Co. *v.* Erwin, 84 Ind. 457.

[2] Shaw *v.* National Bank, 101 U. S. 564; Bradner *v.* Campbell, 55 N. Y. 456; Saltus *v.* Everett, 20 Wend. 267; Farmers' Bank *v.* Logan, 74 N. Y. 568; Coggill *v.* Hartford R.R. Co. 3 Gray, 545; State Bank *v.* Gardner, 15 Ib. 362; Maybee *v.* Tregent, 47 Mich. 495; Evansville etc. R.R. Co. *v.* Ervin, supra.

erty, and the vendor is entitled to recover the same, although for any sums paid to the vendee before notice, the pledgee is entitled to a credit. Nor is the right of the unpaid vendor affected by the fact that other moneys have been mingled with the proceeds of his property.[1] The holder of one of a set of three bills of lading as collateral security for an advance to the consignee, where chargeable with notice that others of the set have already been transferred by the consignor as collateral security for advances, can acquire no rights in opposition to those of the first pledgee.[2] An agreement to advance $3,000 was made upon certain specified property, the lender paying $1,500 at the time, and $1,500 upon the indorsement and delivery of a bill of lading. Prior to the receipt of such bill, another bill of lading covering the same goods was obtained by fraud, and pledged to secure another proposed advance, which was, however, not made until after the second pledgee had notice of the transfer of the first bill of lading. The title of the first pledgee was preferred to the extent of his whole advances.[3]

§ 403. The Pledgee's title subject to terms of Bill of lading.—Where property is in transitu or remains in the possession of a carrier or wharfinger undelivered, a presumption arises that bills of lading are in existence, and all persons dealing with such property, although advancing value, do so at their peril, in the absence of such bill of lading. The production of the bill of lading which is the indicia or muniment of title so long as the goods remain in the possession of the carrier or wharfinger, may disclose that its face shows some special clause or notation or restriction upon de-

[1] Dows *v.* Kidder, 84 N. Y. 121; Van Alen *v.* American Nat. Bank, 52 Ib. 1; Caussidere *v.* Beers, 41 Ib. 198; Cobb *v.* Dows, 10 Ib. 341; United States *v.* State Bank, 96 U. S. 30; Merrill *v.* Bank, 18 Pick. 32; Veil *v.* Mitchell, 4 Wash. 105; Frith *v.* Cortland, 2 H. & M. 417; Pennell *v.* Deffell, 4 DeG. M. & G. 372.

[2] Gnilbert *v.* Guignon, L. R. 8 Ch. 16; Shaw *v.* National Bank, 101 U. S. 564.

[3] Stevens *v.* Boston R. R. Co. 8 Gray, 262.

livery of the property, or there may be indorsed upon it a contract of pledge under which the proceeds of the sale of the property are devoted to the payment of a certain advance, or some other specific indorsement. Purchasers or pledgees of property described in a bill of lading, so indorsed, although without notice and paying value, are subject to defenses arising from the instrument. Their duty is to call for its production, since upon neglect so to do, any rights acquired in the property are subject to the equities and liens of which they have constructive knowledge or notice.[1] This rule was enforced in the cases of purchasers of property covered

[1] Bank of Rochester *v.* Jones, 4 N. Y. 497; Bank of Commerce *v.* Bissell, 72 Ib. 615; Marine Bank *v.* Fiske, 71 Ib. 353; First Nat. Bank *v.* Shaw, 61 Ib. 283; s. c. 71 Ib. 353; Mechanics' Bank *v.* Farmers' Bank, 60 Ib. 40; Farmers' Bank *v.* Logan, 74 Ib. 568; Farmers' Bank *v.* Hazeltine, 78 Ib. 104; Dows *v.* Perrine, 16 Ib. 325. In Farmers' Bank *v.* Logan, supra, p. 585–6, sustaining the rights of a bank, which had discounted a draft, upon the security of a bill of lading, upon which it placed a restrictive indorsement, as against purchasers from an agent whose sale was a fraud upon the pledgee, the Court of Appeals of New York (Folger, J.) say: "It appears that there were infirmities in the title which the appellants [the purchasers] got from Brown [the agent], or rather they got no title from him; for there had never been a contract *de facto* which purported to pass the property from the owner to him. All that the appellants had, upon which they had a right to rely, was the fact of the possession of the wheat by Brown, and the purchase of it by them, in accordance with the usual course of business on the produce exchange. * * * The purchaser of chattel property buys at his risk of the title, and if he would be safe, must make inquiry. He may not, with certainty, stop at the fact of possession, but must learn how the possession has been acquired. In every such case as this, the muniments of a real title are easy to be produced. When the property is, in fact, in the carrier's hands, the bill of lading will show to whom alone he has the right to deliver it. And if the directions of that document are relied upon, there cannot be much risk. A reliance upon it, and a prior inspection of it, may delay transactions, but they will protect all innocent and well-meaning parties, and thwart seriously only those who mean to do wrong or are too reckless to try to do right. The appellants were not protected by the fact of possession in Brown, because possession alone does not give the power to pass a valid title. Hence when they bought of him they got no greater right than he had in the wheat."

by a bill of lading with a restrictive indorsement;[1] and upon the default of one of the purchasers in payment of the judgment the pledgee obtained a further judgment as against a warehouseman, chargeable with notice of the restricted terms of a bill of lading and who had delivered the goods.[2] And a judgment was obtained against a carrier, also chargeable with like knowledge, who had been guilty of a wrongful delivery, although claiming protection under a custom to deliver to parties to whom notice was requested to be sent by the bill of lading, as in the case in question.[3]

§ 404. The Pledgee's remedies for misappropriation of Property.—The indorsement and delivery of a bill of lading as collateral security for a loan or discount of commercial paper, vesting the legal title in the property and the right of possession in the pledgee, entitles him to an action of replevin where the consignor or any other person has attached the goods.[4] Where goods covered by a bill of lading indorsed and in the hands of a pledgee for value, have been sold under legal process, the pledgee may appear in the proceedings, and will be allowed to recover so much of the

[1] Farmers' Bank *v.* Logan, 74 N. Y. 568; Farmers' Bank *v.* Atkinson, 74 N. Y. 587. The special indorsement on these bills of lading read: "To E. S. Brown:

"The property mentioned in this bill of lading, with insurance on the same, is pledged to the Farmers and Mechanics' Bank of Buffalo as security for the payment of the accompanying draft for $7,791.77, and the property is placed in your custody in trust for that purpose, and is not to be diverted to any other use until the draft is paid; and upon your accepting and paying the draft the claim of the bank will cease. Without recourse.

F. Sidway, cashier."

[2] Farmers' and Mechanics' Bank *v.* Hazeltine, 78 N. Y. 104.

[3] Bank of Commerce *v.* Bissell, 72 N. Y. 615. In Ontario Bank *v.* New Jersey Steamboat Co. 59 Ib. 510, the bank was not permitted to object in an action against the carrier, to a delivery to the party directed to be notified by reason of the long-continued custom so to treat like shipments between the same parties, where no restrictive indorsements appeared on the bill of lading.

[4] Alderman *v.* Eastern Ry. Co. 115 Mass. 233; Stone *v.* W. St. Louis etc. Co. 9 Bradw. 48; Mich. Cen. R. R. Co. *v.* Phillips, 60 Ill. 190; Peters *v.* Elliot, 78 Ib. 336.

proceeds as against the creditor, as is equal to the amount of his advances.[1] The pledgee of a bill of lading may bring an action of trover for the conversion of the property against anyone who does not show a better title;[2] and may recover the full value of the goods, holding any surplus beyond the amount of his own advance for the general owner.[3] Trover, however, will not lie as against a commission merchant who has sold grain consigned to him for sale, the bills of lading of which had been pledged for advances, and who retains the proceeds on account of the indebtedness of the shipper to him under a previous agreement. The action should be for money had and received.[4] Where there has been a wrongful delivery of goods by a shipmaster, an indorsee of a bill of lading providing for delivery "to order or assigns," is entitled to libel the vessel on which such goods were shipped for failure to deliver them. Nor is it material that the indorsee is only an agent or trustee for others, as a cashier of a bank which has made advances bona fide on such bill of lading.[5] Instructions were given to a bank to indorse a bill of lading only upon payment of the draft to which it was attached, which, having been paid with borrowed money, the bill of lading upon delivery was at once indorsed as collateral security to the lender. The legal title to the goods having passed to the pledgee by such indorsement as against a previous vendee of the goods "to arrive," an action for conversion against a railroad company delivering the goods to the vendee was sustained, although, being a connecting line, it had no knowledge of the bill of lading.[6]

§ 405.—The unpaid Vendor's right of Stoppage in transitu.—Stoppage in transitu is a right which an unpaid

[1] Hathaway *v.* Haynes, 124 Mass. 311.

[2] Adams *v.* O'Connor, 100 Mass. 515; Burke *v.* Savage, 13 Allen, 405; Dows *v.* Nat. Bank, 91 U. S. 618; Tiedman *v.* Knox, 53 Md. 612.

[3] Allman *v.* Barnard, 7 Gray, 554; Adams *v.* O'Connor, supra; Harris *v.* Birch, 9 M. & W. 591.

[4] Taylor *v.* Turner, 87 Ill. 296.

[5] The Thames, 14 Wall. 98.

[6] Alderman *v.* Eastern R. R. Co. 115 Mass. 243.

vendor has, when selling goods on credit, to resume control and possession of property while in the custody of a carrier or middleman, in transitu to the vendee, and before delivery, in the event of the insolvency of the latter, occurring subsequently to the sale of the goods.[1] The right exists only as between vendor and vendee, or consignor and consignee.[2] The delivery of goods, sufficient to defeat the vendor's right of stoppage in transitu, may be at a place from which the consignee intends to order them to a new destination.[3] The right of stoppage in transitu by the unpaid vendor operates, not as a rescission of the contract of sale, but as an assertion of the unpaid vendor's right to enforce a lien for the purchase money. The effect of its exercise is to revest the consignor in his rights as an unpaid vendor as against the vendee, but not to rescind the contract of sale between the parties.[4]

The right of stoppage in transitu of the unpaid vendor, however, is defeated by an indorsement and delivery of the bill of lading, to a bona fide pledgee, for a valuable consideration, without notice of any facts upon which a right of stoppage in transitu might arise. To the extent of the pledgee's advances, the owner is not permitted to insist upon his right to intercept the goods consigned to the insolvent consignee.[5] The rights of a pledgee are sustained where

[1] Newhall *v.* Varges, 15 Me. 314; Eaton *v.* Cook, 32 Ib. 58; Railroad Co. *v.* Freed, 38 Ark. 614; Cabeen *v.* Campbell, 30 Pa St. 254; Calahan *v.* Babcock, 21 Ohio St. 281.

[2] Kinlock *v.* Craig, 3 Term, 781.

[3] Covell *v.* Hitchcock, 23 Wend. 611; Harris *v.* Pratt, 17 N. Y. 249; Becker *v.* Hallgarten, 86 Ib. 167, 174; Biggs *v.* Barry, 2 Curtis, 259; Valpy *v.* Gibson, 4 C. B 837; Dixon *v.* Baldwin, 5 East, 175; Bolton *v.* Railroad Co. L. R. 1 C. P. 439.

[4] Babcock *v.* Bonnell, 80 N. Y. 244; Rowley *v.* Bigelow, 12 Pick. 307; Stanton *v.* Eager, 16 Ib. 467, 475; Arnold *v.* Delano, 4 Cush. 33, 39; Newhall *v.* Varges, 13 Me. 93; s. c. 15 Ib. 314; Rogers *v.* Thomas, 20 Conn. 83; Ellis *v.* Jones, 5 Ohio, 88, 98; Harris *v.* Pratt, 17 N. Y. 263; Kemp *v.* Falk, L. R. 7 App. 573. 581 (Lord Blackburn).

[5] Becker *v.* Hallgarten, 86 N. Y. 167; Rawles *v.* Deshler, 42 Ib. 572; Dows *v.* Greene, 32 Barb. 490; Loeb *v.* Peters, 63 Ala. 243; Lee *v.* Kimball, 45 Me. 172; Audenried *v.* Randall, 3 Cliff. 99; Walter *v.* Ross, 2 Wash. 283; Chandler *v.* Fulton, 10

a bill of lading is taken in his own name, or of persons acting in his behalf as agents. Receiving a bill of lading so drawn, the pledgee is entitled to the same rights as against an unpaid vendor as if he had received as collateral security a bill of lading to the order of the consignee and vendee, indorsed and delivered.[1] The hypothecation of a bill of lading by a vendee as collateral security for a loan made in good faith, where the amount is less than the actual value of the goods covered by the bill of lading, is not sufficient in equity to defeat the right of stoppage in transitu of the unpaid vendor, so far as the property is of value in excess of the valid claims of the pledgee, or his recovery of the proceeds of the goods held by the pledgee after reimbursement of his advances.[2] The pledgee is not allowed, under such circumstances, to appropriate a balance remaining in his hands, to the liquidation of a general account with the pledgor, as against such unpaid vendor.[3]

§ 406.—The Pledgee a Holder for value, as against unpaid Vendor.—In the leading case of Kemp *v.* Falk, recently decided by the English House of Lords, a purchaser of goods on credit, shipped by the vendor, indorsed the bill of lading to a bank as security for an advance. Before the arrival of the ship, the consignees sold the goods "to arrive" to sub-purchasers. The vendee became bankrupt, and before delivery and payment by the sub-purchasers, the vendor gave notice of a stop to the shipmaster. The consignees remitted the proceeds of the sub-sales to the pledgee, which, after repaying itself, handed the balance to the trustees in bankruptcy of the vendee. The right of stoppage

Tex. 2; Vertue *v.* Jewell, 4 Camp. 31; Lickbarrow *v.* Mason, 2 Term, 63.

[1] Becker *v.* Hallgarten, 86 N. Y. 167.

[2] Kemp *v.* Falk, L. R. 7 App. 573, 577; affirming s. c. L.R. 14 Ch. D. 446; ex parte Golding, L. R. 13 Ch. D. 624; Coventry *v.* Gladstone, L. R. 6 Eq. 44; Berndtson *v.* Strang, L. R. 4 Eq. 486; s. c. L. R. 3 Ch. 588; In re Westzinthus, 5 B, & Ad. 817; Spalding *v.* Ruding, 6 Beav. 376.

[3] Spalding *v.* Ruding, 6 Beav. 376; aff. 15 L. J. Ch. 374; Halsey *v.* Warden, 25 Kan. 128.

in transitu of the unpaid vendor was not at an end when the notice to the master was given, so that the vendor was entitled to the balance after payment of the pledgee's advances. Lord Blackburn, in the House of Lords, held that such a negotiation of a bill of lading as collateral security was clearly a transfer for value, and as such, so far as it went, it defeated the right of stoppage in transitu, but left it to apply to everything that was not covered by the pledge.[1] Lord Selborne (Lord Chancellor) also approved this view, adding, "Against what is this right of stoppage in transitu? Not against some imaginary interest of the purchaser, but against the goods themselves. It is a right to stop the goods, when they are still in transitu in contemplation of law. It is a qualified right in this case, because it cannot be asserted as against the holder of the bill of lading without paying him off; but the instant his claim is discharged, it is exactly the same right as if there had been no security, as against the original purchaser and as against, in my opinion, every one claiming under him."[2] The case decided, as stated by Lord Fitzgerald, "that the claim of the unpaid vendor against the surplus produce of his own goods, after providing for all prior rights, is superior to that of the creditors of the vendee who had not paid for the goods."[3]

[1] Kemp *v.* Falk, L. R. 7 App. 573, 582.

[2] L. R. 7. App. 577.

[3] L. R. 7 App. 590.

CHAPTER XLII.

THE FACTOR AS PLEDGOR.

§407. At common law, the factor cannot pledge, but may assign lien.
408. The character and extent of the factor's lien.
409. The factor, making advances, becomes a pledgee.
410. The pledgee, with notice, subject to equities.
411. The pledgee's title protected, as against owner, factor, etc.

§ 407.—AT COMMON LAW, THE FACTOR CANNOT PLEDGE, BUT MAY ASSIGN LIEN.—At common law, a factor has no authority to pledge the goods of his principal for advances made to him on his own account, or to secure his individual debts,[1] nor is it under the common law, material that the pledgee making such advances is ignorant that the factor is not the owner of the goods.[2] The authority of the factor, under the common law, being only to sell, the right to

[1] Paterson *v.* Tash, 2 Strange, 1178; Newsom *v.* Thornton, 6 Ib. 17; McCombie *v.* Davies, 7 Ib. 5; Daubigny *v.* Duval, 5 Term R. 604; Navulshaw *v.* Brownrigg, 1 Sim. N. S, 573. Kelly *v.* Smith 1 Blatchf. 290; Davis *v.* Russell 52 Cal. 611; Wright *v.* Solomon, 16 Cal. 72; Newbold *v.* Wright, 4 Rawle 195; Lansatt *v.* Lippincott, 6 Ib. 391; First Nat. Bank *v.* Nelson, 38 Ga. 391; Bott *v.* McCoy, 20 Ala. 578; Odiorne *v.* Maxey, 13 Mass. 178; Shaw *v.* Stone, 1 Cush. 228; Bonito *v.* Mosquiero. 2 Bosw. 401; McCreary *v.* Gaines, 55 Tex. 485; Gray *v.* Agnew, 95 Ill. 315; Van Amrige *v.* Peabody, 1 Mason. 440; Evans *v.* Potter, 2 Gall. 13; Rodriguez *v.* Hefferman, 5 Johns. Ch. 429; Kennedy *v.* Strong, 14 Johns. 28. The like rule prevailed in Louisiana prior to the act of 1876. Stetson *v.* Gurney, 17 Lou. 166; Miller *v.* Schneider, 19 La Ann. 300; Young *v.* Scott, 25 Ib. 313, and the factor is now restricted to pledging to the amount only of his interest. Insurance Co. *v.* Kiger, 103 U. S. 352.

[2] Gray *v.* Agnew, 95 Ill. 315, 320; Rodrigucz *v.* Hefferman, 5 Johns. Ch. 429; Martin *v.* Cowles, 1 M. & S. 140; Newsom *v.* Thornton, 6 East, 17.

pledge was refused to him, even for the purpose of raising funds to meet bills of exchange drawn against the goods offered as security, and in cases where the proceeds of the loan were applied to the use of the principal in other ways.[1] The common law rule as to the absence of power of the factor to pledge goods of his principal being recognized, a change in the law relating to factors, if desirable for the protection of third persons, lies rather within the province of legislatures than of the courts.[2] The factor, however, under the common law, may deliver the property of his principal into the custody of a third person for an advance, with notice of his lien, and upon such transfer, the pledgee becomes entitled to retain the property to the extent of the factor's lien.[3] If such a transfer has been made bona fide, the principal must pay or tender the amount of such advances and lien before an action to recover the goods can be sustained.[4] But no rights can be acquired by a transfer of the property where circumstances of fraud have intervened, and neither the factor nor his assigns are permitted to retain possession of such property, even for the payment of the liens and charges of the factor.[5]

§ 408. THE CHARACTER AND EXTENT OF THE FACTOR'S LIEN.—The factor can only claim a lien on the goods in his possession. Such possession must be lawful, and not obtained by any illegal or tortious act,[6] while authority to an agent to sell goods will not authorize him to pledge

[1] Bonito *v.* Mosquiero, 2 Bosw. 401; Newsom *v.* Thornton, 6 East. 17; McCombie *v.* Davis, 7 East. 5.

[2] McCreary *v.* Gaines, 55 Tex. 485.

[3] Mann *v.* Shiffner, 2 East. 523, 529; McCombie *v.* Davis, 7 Ib. 6; Urquhart *v.* McIver, 4 Johns. 103; Rodriguez *v.* Hefferman, 5 Johns. Ch. 429.

[4] Hartop *v.* Hoare, Stra. 1187; Daubigny *v.* Duval, 5 Term, 604; Warner *v.* Martin, 11 How. 225.

[5] Daubigny *v.* Duval, supra; Patterson *v.* Tash, 2 Strange, 1187; Gray *v.* Agnew, 95 Ill. 315, 320; Newbold *v.* Wright, 4 Rawle, 195; Davis *v.* Bigler, 62 Pa. St. 242; Rodgers *v.* Grothe, 58 Ib. 414.

[6] Bank of Rochester *v.* Jones, 4 N. Y. 497.

them.[1] Bad faith on the part of the person receiving goods, or a prohibition by the owner against pledging them, will invalidate an act of pledge by a factor.[2] A factor or commission merchant, in the absence of statute, is not authorized to pledge the goods of his principal for his own use;[3] and the pledgee, although he takes the goods, or the documents of title, without notice that the pledgor is a factor or agent, has no better title than the factor.[4] And the same rule is applied as to pledges by factors for antecedent debts.[5]

The factor who has made advances upon shipments by his principal, is given a lien on the property to the amount of the advance. The lien thus given is of a special character and does not affect the general ownership of the principal in the property. The owner, by forwarding goods to a factor for sale, and receiving advances, does not thereby abandon his title, but may at any time before sale by the factor reclaim possession, upon the equitable terms of repaying the factor's advances and other proper charges. If the factor sell the property to reimburse himself for his advances, the surplus, if any, will enure to the benefit of the principal.[6] And a court of equity will take jurisdiction, and enforce performance of a trust in favor of the holder of any

[1] Davis *v.* Russell, 52 Cal. 611; Voss *v.* Robertson, 46 Ala. 483; Bott *v.* McCoy, 20 Ala. 578; Bonito *v.* Mosquiero, 2 Bosw. 401; Henry *v.* Marvin, 3 E. D. Smith, 71; Easton *v.* Clark, 35 N. Y. 225, ex parte Alston, L. R. 4 Ch. 168; Broadbent *v.* Barlow, 3 DeG. F. & J. 570.

[2] Navulshaw *v.* Brownrigg, 1 Sim. N. S. 573; 2 DeG. M. & G. 441.

[3] Bott *v.* McCoy, 20 Ala. 578; Easton *v.* Clark, 35 N. Y. 225.

[4] Bott *v.* McCoy, 20 Ala. 578.

[5] Warner *v.* Martin, 11 How. 209. Kelly *v.* Smith, 1 Blatchf. 290; Henry *v.* Marvin, 3 E. D. Smith, 71; Macnee *v.* Gorst, L. R. 4 Eq. 315; Jewan *v.* Whitworth, L. R. 2 Eq. 692; Fuentis *v.* Montis, L. R. 3 C. P. 268; s. c. 4 Ib. 93. A debtor shipping goods to his factor for sale, and to apply the proceeds to the payment of an antecedent debt, and forwarding the bill of lading, may afterwards change the shipment to another person, without making the common carrier liable to the factor. Craft *v.* Miss. & T. R. R. Co. 59 Miss. 182.

[6] United States *v.* Villalonga, 23 Wall. 35.

note or draft entitled to the proceeds of the goods, as against a factor receiving the same to sell for the benefit of such holder.[1] Even a statute extending the factor's lien to all balances on general account, and to the proceeds of sale of goods as to the goods, merely gives a lien protected by possession.[2]

§ 409. THE FACTOR, MAKING ADVANCES, A PLEDGEE.— The relation of the factor and principal, where the former has made advances on the goods entrusted to him, is barely distinguishable from that of the pledgor and pledgee.[3] A wrongful sale or pledge of property by the factor, while it will not leave the contract of pledge intact, does not destroy it.[4] Upon an action by a principal against a pledgee to recover the property, his claim is subject to the equitable deduction of the amount for which the factor had a valid lien, although as against the wrongful pledgor, the principal may recover his damages, nominal or special, as the case may warrant.[5] The measure of damages in an action of tort is the value of the property, less the amount of the advance;[6] and interest on the balance may be added.[7] In an action of

[1] DeWolf *v.* Gardner, 12 Cush. 19; Rodriguez *v.* Heffernan, 5 Johns. Ch. 417; Warner *v.* Martin, 11 How. 224; Patterson *v.* Tash, 2 Stra. 1178; Guerriero *v.* Peile, 3 B. & Ald. 616; Newsom *v.* Thornton, 6 East. 17.

[2] United States *v.* Villalonga, 23 Wall. 35.

[3] Donald *v.* Suckling, L. R. 1 Q. B. 597; Steiger *v.* Third Nat. Bank, 2 McCrary, 491.

[4] Johnston *v.* Stear, 15 C. B. (N. S)., 330.

[5] First Nat. Bank *v.* Bryce, 78 Ky. 42; Donald *v.* Suckling, L. R. 1 Q. B. 599; Johnston *v.* Stear, 15 C. B. (N. S)., 330.

[6] Shaw *v.* Ferguson, 78 Ind. 547; First Nat. Bank of Louisville *v.* Bryce, 78 Ky. 42; Fowler *v.* Gilman, 13 Met. 267; Briggs *v.* Boston R. R. Co., 6 Allen, 246; Clark *v.* Dearborn, 103 Mass. 335; Whitney *v.* Beckford, 105 Ib. 267; Belden *v.* Perkins, 78 Ill. 449; Chinnery *v.* Viall, 5 H. & N. 287; Brierly *v.* Kendall, 17 Q. B. 937; Donald *v.* Suckling, L. R. 1 Q. B. 597; Johnston *v.* Stear, supra; Halliday *v.* Holgate, L. R. 3 Ex. 299.

[7] Fowler *v.* Gilman, 13 Met. 269; Briggs *v.* Boston R. R. Co., 6 All. 246.

trover, a tender of advances and charges of the factor must be made before suit is commenced.[1] Where the act of pledge by the factor is in excess of his advances and charges, the owner of the goods may recover from the pledgee, who has converted the same, the damages actually sustained by the wrongful pledge and conversion of the property, being the fair value of the goods, if sold in the usual course of business, after deducting commissions, and any payments of the factor in connection with the special goods covered by the illegal pledge.[2] A bill in equity will not lie to enforce the payment by a factor of proceeds of his sale, upon the ground that the moneys constitute a trust fund, there being ample remedy at law.[3]

§ 410. THE PLEDGEE, WITH NOTICE, SUBJECT TO EQUITIES. — Bales of cotton were consigned to factors, with instructions not to sell, but to hold for further directions and better prices, and the firm stored the cotton in a warehouse. The factors at the time were considerably in debt to their principal, and had no pecuniary interest in the particular shipment. Shortly afterwards the factors obtained an advance from an insurance company giving the cotton-press receipts, made deliverable to the order of the company, as collateral security. Before the maturity of the notes for which the receipts were given as collateral, the factors failed. In a suit to settle claims to the property pledged, to which all were parties, judgment was entered for the consignor.[4] Goods consigned to a factor or agent for sale, were pledged to a bank aware of the principal's ownership, together with certain notes made by the principal to the factor which it was understood should be paid from the proceeds of the goods. The bank, being charge-

[1] Steiger *v.* Third Nat. Bank, 2 McCrary, 494.

[2] Alabama etc. Manf. Co. *v.* Third Nat. Bank, 12 Mo. App.

[3] Taylor *v.* Turner, 87 Ill. 303; Navulshaw *v.* Brownrigg, 1 Sim. (N. S.) 573; 2 DeG. M. & G. 441.

[4] Insurance Co. *v.* Kiger, 103 U. S. 352.

able with notice, was required to apply the proceeds of the property to the payment of the notes; and the defense thus arising was available to an action upon the notes by the pledgee as indorsee.[1] No rights or title can be acquired by a pledgee, chargeable with negligence, under a pledge by a consignee, not being a factor, and having no indicia of title nor possession of the property.[2]

Under statutes giving validity to the claims of pledgees receiving warehouse receipts and other indicia of property from factors or agents as collateral security for advances, the like rule as to notice prevails. It is an essential requisite that the pledgees, in cases of misappropriation of such property as bills of lading, indicia of title, should have received the same in good faith and without knowledge of the want of authority of the factor or agent so to use the same. Where a pledgee is chargeable with notice of such facts, he is not a holder for value of the property, nor of the documents of title, although he may have paid value therefor.[3] The goods may be recovered by the principal or owner in an action of replevin, or other appropriate action, without tendering repayment of the loan.[4] The lien of the factor for his charges is not deducted from his demand, only in cases where a demand for such charges has been made.[5]

§ 411. The Pledgee's title protected, as against Owner, Factor, etc.—If the owner of property, or of documents of title or of property, entrusts the same to a third person, a factor, so that he appears to have a good title to the same and an apparent ownership, he enables such factor

[1] St. Louis Nat. Bank *v.* Ross, 9 Mo. App. 399.

[2] Chicago Taylor, etc. Co. *v.* Lowell, 60 Cal. 454.

[3] Macky *v.* Dillinger, 73 Pa. St. 85; Easton *v.* Clark, 35 N. Y. 225; Wilson *v.* Nason, 4 Bosw. 40; Stevens *v.* Wilson, 6 Hill, 512; First Nat. Bank *v.* Nelson, 38 Ga. 391; St. Louis Nat. Bank *v.* Ross, 9 Mo. App. 399.

[4] Macky *v.* Dillinger, 73 Pa. St. 85; Stevens *v.* Wilson, 6 Hill, 512.

[5] Merchants' Nat. Bank *v.* Trenholm, 12 Heisk. 520; Macky *v.* Dillinger, 73 Pa. St. 85.

by fraud and deceit, to obtain from a pledgee an advance of money upon the credit of such property or indicia of property. If a loan has been made in good faith, and without notice, the principal is without defense as against the pledgee, although the act of pledge be a misappropriation and fraud, and not included in the secret agreement of the parties.[1] An indorsement and delivery of the documents of title, symbols of property, must be made at the time of the advance.[2] And where other securities besides the bill of lading are pledged by the factor for advances made by a third person to himself, the principal is entitled to require in the event of the factor's insolvency, that the other securities shall be first resorted to, or that he shall be given a lien thereon for the balance due upon the special consignment.[3] The rights of a bona fide pledgee for value, of documents of title to goods, held in a warehouse by a factor, and receiving a warehouse receipt acknowledging the pledgee's title to the cotton, were protected as against a subsequent fraudulent sale thereof by the factor, and delivery to the purchaser by the warehouseman, notwithstanding part of the proceeds were paid by the factor to the pledgees on account of a debt antecedent to that for which the cotton was pledged, but without their knowledge.[4] And a pledge made by a factor of a warehouse receipt, the funds being advanced on the credit of the representations contained in the receipt, and of the pledgor's possession, was sustained, although the invoice of the goods would have shown that the goods belonged to the principal.[5]

[1] Cartwright *v.* Wilmerding, 24 N. Y. 521; Botts *v.* McCoy, 20 Ala. 578; Bonito *v.* Mosquero, 2 Bosw. 401; Gray *v.* Agnew, 95 Ill. 320.

[2] Bonito *v.* Mosquero, 2 Bosw. 410.

[3] Ex parte Alston, L. R. 4 Ch. 168; Broadbent *v.* Barlow, 3 DeG. F. & J. 570.

[4] Bott *v.* McCoy, 20 Ala. 578.

[5] Cartwright *v.* Wilmerding, 24 N. Y. 521.

Div. 3.—WAREHOUSE RECEIPTS.

CHAPTER XLV.

WAREHOUSE RECEIPTS AS COLLATERAL.

§412. The warehouse receipt quasi-negotiable.
413. Transfer in pledge, with or without indorsement.
414. The pledgee of warehouse receipts, a holder for value.
415. Estoppel of owner, where third person holds apparent title.
416. Estoppel of warehouseman, by terms of receipts.
417. No title acquired by pledgee, with notice of fraud or felony.
418. Pledges supported, upon delivery of receipt and possession.
419. Possession, actual or implied, necessary to valid pledge.
420. Pledge by warehouseman of receipts for his own property.
421. The warehouseman as pledgor, under statutory enactments.

§ 412.—The Warehouse receipt quasi-Negotiable. —Except in the rare cases where statutory enactments have made warehouse receipts negotiable as bills of exchange or promissory notes, a warehouse receipt is not a negotiable instrument, and its indorsement and delivery, or delivery merely where payable to "holder," carries none of the effects as to cutting off the defenses of the warehouseman against the original holder, nor is there any certain time at which it matures, nor is the title of the person loaning money upon it protected when lost or stolen, as in the case of commercial paper. Nor is the warehouseman a guarantor of the title of property held by him, and for which he has issued a receipt Issued, however, "subject to the order

hereon" of the person depositing the property, "and the surrender of this receipt," it becomes a representation on the part of the warehouseman to every successive holder for value, under indorsement in blank, that he has the property in store, and by a transfer of it the title to the property and right to its possession pass to the indorsee as if the property were actually delivered. The title thus acquired, as between the parties to the transfer, is such a title as if the property itself were delivered, no better and no worse. The warehouseman may, by his direct representations on the face of the receipt, when in the hands of an innocent holder for value advanced upon the face of its statements, estop himself to show that he has not the property or to set up any fraud, or wrongful delivery procured by misrepresentation. In such cases, and generally by reason of its negotiability by transfer from hand to hand under blank indorsement, the warehouse receipt comes within the class of quasi-negotiable instruments, equally with certificates of stock, and bills of lading.[1]

The transfer of warehouse receipts, by indorsement and delivery carries with it, in exceptional cases, under statutory enactments, the privileges of negotiability. The receipt, in the hands of third persons, holders for value advanced, without notice of equities, is given the same freedom from antecedent equities as the favored instruments of commerce, bills of exchange and promissory notes. Any defense the warehouseman might have had as against the original holder of the receipt is cut off as against an indorsee for value, without notice.[2] Where the provision is, that

[1] Insurance Co. *v.* Kiger, 102 U. S. 352; Canadian Bank *v.* McCrea, 106 Ill. 281; Burton *v.* Curyea, 40 Ib. 320; First Nat. Bank *v.* Bates, 1 Fed. Rep. 702; McNeil *v.* Hill, 1 Woolw. 96; Allen *v.* Maury, 66 Ala. 10; Gibson *v.* Chillicothe Bank, 11 Ohio St. 311; Yenni *v.* McNamee, 45 N. Y. 614; Whitlock *v.* Hay, 58 Ib. 484; Stewart *v.* Phœnix Ins. Co., 9 Lea, 104; Davis *v.* Russell, 52 Cal. 611.

[2] Gibson *v.* Stevens, 8 How. 384; Erie & P. Disp. Co. *v.* Compress Co., 6 Mo. App. 175; People's Bank *v.* Gayley, 92 Pa. St. 518; s. c. 12 Phila. 183; First Nat. Bank *v.* Bryce, 78 Ky. 42; Greenbaum *v.* Megibben, 10 Bush, 419.

warehouse receipts "shall be transferable by the indorsement of the party to whose order such receipt may be issued, and such indorsement shall be deemed a valid transfer of the property represented by such receipt, and may be made either in blank or to the order of another," the element of negotiability does not follow. The provisions of such statutes are regarded, as in the case of like statutes relating to bills of lading, as relating to the mode of transfer only, and neither authorize nor imply that the indorser can convey a title to the property represented by the receipt which he does not possess.[1]

§ 413.—Transfer in Pledge, with or without indorsement.—The transfer for value as collateral security of warehouse receipts, by indorsement and delivery, or by delivery only, where such receipts are made payable to "holder" or "only upon the return of this receipt," vests the legal title and possession of the property in the pledgee, and is equivalent to an actual delivery of the property. The warehouseman at once, without notice, becomes the bailee of the lender of money upon the receipt he has issued. The title to the property passes by such transfer to the pledgee under the law merchant, independent of any statute.[2] A formal assignment of the document is not required, as the

[1] Shaw *v.* Railroad Co. 101 U. S. 557; Canadian Bank *v.* McCrea, 106 Ill. 281; Burton *v.* Curyea, 40 Ill. 320.

[2] Cool *v.* Phillips, 66 Ill. 217; Broadwell *v.* Howard, 77 Ib. 305; Burton *v.* Curyea, 40 Ib. 320; Lehman *v.* Marshall, 47 Ala. 362; Allen *v.* Maury, 66 Ib. 10; Horn *v.* Baker, 8 Cal. 614; Davis *v.* Russell, 52 Ib. 611; Gibson *v.* Chillicothe Bank, 11 Ohio St., 311; National Bank *v.* Walbridge, 19 Ib. 424; Motham *v.* Heyer, 5 Denio, 629; Gardner *v.* Suydam, 7 N. Y. 357; Wilkes *v.* Ferris, 4 Johns. 355; Waldron *v.* Romaine, 22 Ib. 368; Cartwright *v.* Wilmerding, 24 N. Y. 521; St. Louis Nat. Bank *v.* Ross, 9 Mo. App. 399; Fourth Nat. Bank *v.* Compress Co., 11 Ib. 333; Stewart *v.* Phœnix Ins. Co., 9 Lea, 104; Gibson *v.* Stevens, 8 How. 384; Insurance Co. *v.* Kiger, 103 U. S. 353, 357; Harris *v.* Bradley, 2 Dill. 285; McNeil *v.* Hill, 1 Woolw. 96; Bank of British Columbia *v.* Marshall, 11 Fed. Rep. 19; Rice *v.* Cutler, 17 Wis. 351; Whitney *v.* Tibbitts, Ib. 359; Lickbarrow *v.* Mason, 1 Sm. L. C. pt. 2, 1197.

indorsement of itself sufficiently indicates the intention of the pledgor to pass the title and possession.[1] Such indorsement and delivery transfers the general property in the goods to the pledgee as absolutely as would a bill of sale.[2] When once indorsed in blank, such receipts pass from hand to hand by delivery merely.[3] The delivery of a warehouse receipt, without indorsement, as collateral security, is sufficient to transfer the title and possession of the property represented, if such be the intention of the parties.[4] Even where in the language of a statute such receipts "may be transferred by indorsement," the provision is regarded as permissive only, and is without effect upon the right to transfer by delivery existing independently of the statute.[5] Mere delivery under a statute requiring indorsement may constitute a pledge, but none of the advantages of negotiability will attach to such transfer, although the receipt be payable to "bearer."[6] No privilege is conferred upon a pledgee under the civil code of Louisiana by the assignment of a warehouse receipt, in the absence of an express contract that the property is given in pledge to secure the payment of a specified debt, the amount of which is stated;[7] and, although warehouse receipts are made "negotiable" under the Civil Code, a warehouseman is not regarded as assuming the liabilities of a guarantor of the title of the property described in receipts issued over his signature.[8]

§ 414. The Pledgee of Warehouse receipts, a Holder for value.—The pledgee of warehouse receipts,

[1] Gibson *v.* Stevens, 8 How. 384. (Taney, C. J.)

[2] McNeil *v.* Hill, 1 Woolw. 96.

[3] Davis *v.* Russell, 52 Cal. 611.

[4] Whitney *v.* Tibbetts, 17 Wis. 359; Merchants Bank *v.* Hibbard, 48 Mich. 118; Herr *v.* Zarker, 8 Cal. 603; Gibson *v.* Stevens, 8 How. 384; Rice *v.* Cutler, 17 Wis. 351.

[5] Rice *v.* Cutler, 17 Wis. 351.

[6] St. Louis Nat. Bank *v.* Ross, 9 Mo. App. 399. Indorsement is required in Alabama under Code § 2099. Allen *v.* Maury, 66 Ala. 10; Lehman *v.* Marshall, 47 Ib. 362.

[7] Martin *v.* Creditors, 15 La. Ann. 165; Cater *v.* Merrill, 14 Ib. 375.

[8] Insurance Co. *v.* Kiger, 103 U. S. 352, 356.

receiving the same, with or without indorsement, as collateral upon a bona fide loan or discount of commercial paper, stands in the same privileged position as a bona fide purchaser for value of like receipts. An indefeasible title to the property represented by the receipts is vested in the bona fide pledgee for value, and he is entitled to its possession. His title thus acquired in good faith, for value advanced upon the faith and credit given to the apparent legal title and right to possession of the pledgor, is protected even as against the real owner, although the act of pledge by the person entrusted with the indicia of title representing the property, be a fraud as against an unpaid vendor. Such innocent pledgee is a bona fide holder for value, in the usual course of business; and has something more than a mere lien for his advances, taking the title to the property and the right to its actual possession. An equitable interest only in the property remains in the pledgor, who is entitled to a surrender of the indicia of title upon payment of the loan or debt, and to any surplus arising from the sale of the property, upon default, after payment of the debt.[1] The pledgee of warehouse receipts is under no obligation to notify the warehousemen of the transfer to him of such receipts as collateral security. The representation is usually made upon the face of warehouse receipts that the property described will not be delivered until the surrender of the receipt and its cancellation. The rule applies to third persons, creditors of the pledgor, seeking by legal process to obtain possession of property represented by such receipts, when the same have passed into the hands of pledgees for value advanced in good faith upon the credit of such representations.[2]

[1] Gibson *v.* Stevens, 8 How. 384; Barnard *v.* Campbell, 58 N. Y. 73; Disbrow *v.* McDonald, 5 Bosw. 130; Winne *v.* McDonald, 39 N. Y. 233; Caldwell *v.* Bartlett, 3 Duer, 341; Root *v.* French, 13 Wend. 573; Hoffman *v.* Noble, 6 Met. 68.

[2] First Nat. Bank *v.* Bates, 1 Fed. Rep. 702; 19 A. L. R. (N. S.) 565.

§ 415. Estoppel of Owner, where third person holds apparent Title.—The rules of equitable estoppel are invoked in favor of the innocent pledgee of warehouse receipts, receiving the same from a vendee of the property, for a valuable consideration, advanced on the credit of such receipts, in the usual course of business. The rule is applied where the vendor, although desirous of retaining a lien, has been induced by misrepresentations to entrust the vendee with the indicia of title and possession, so that the latter is able to act as the apparent absolute owner of the property, the pledgee not being chargeable with notice of the equities of the owner. Under such circumstances "there is no principle upon which it can be held that the loss, which must fall somewhere, should fall upon an innocent pledgee, rather than upon the vendor who put it in the power of the pledgor to hold himself out as the sole owner, and alone entitled to the possession of the goods, under circumstances which must have deceived the most vigilant."[1] The like rule of equitable estoppel in favor of innocent pledgees, receiving warehouse receipts, or other indicia of title, to property and its possession, from an apparent owner, in good faith, in the usual course of trade, for value and without notice, is incorporated into the California code. A bona fide pledgee, holding for value, without notice, under an unauthorized use of warehouse receipts, indorsed in blank, as collateral security for an antecedent debt by one entrusted with the indicia of title so as to appear as the owner of the property and entitled to its possession, is protected.[2] A pledgee himself may, by his neglect or through misplaced confidence, bring himself within the rules of equitable estoppel, as where he has permitted the pledgor to take possession of the property, and to obtain warehouse receipts for the same. In such cases the pledgee is estopped to set up his title as against a subsequent pledgee, receiving the

[1] Fourth Nat. Bank *v.* Compress Co. 11 Mo. App. 333, 342.

[2] Davis *v.* Russell, 52 Cal. 611. Civ. Code, Cal. § 2991.

receipts in good faith for value advanced on the credit of his title and possession.[1] The like rule applies where the owner of property allows a party to take warehouse receipts in his own name, being deceived by his fraudulent conduct, and the receipts are negotiated as collateral security to a bona fide pledgee, for value, without notice of the fraud.[2]

§ 416. Estoppel of Warehouseman, by terms of Receipts.—A warehouseman, who has issued a receipt stating that certain goods therein mentioned are in store at his warehouse, and deliverable only upon surrender of the receipt, is not permitted to deny such statements, where, upon the credit of the representations contained in such receipt, a pledgee has advanced value, in good faith, without notice.[3] The rules of equitable estoppel were enforced where, in fact, no property had ever been received by the warehouseman as stated in the receipt, but after issue, as collateral security, the receipt was transferred by indorsement and delivery to a third person for a bona fide advance made on the credit of the representations contained in the receipt, and without notice of the real transaction, as between the original parties. The pledgee was allowed to recover from the warehouseman the value of the goods as recited in the fraudulent receipt.[4] Nor will a warehouseman be permitted to explain the issue of a receipt, where there has been a failure to deliver the property described, on demand, as against a bona fide pledgee for value advanced upon the credit of such representations, without notice of any equities. The pledgee, receiving the receipt by indorsement and delivery, has a right to act upon the stipulation contained on the face of the receipt that delivery of the property will be made only upon its surrender. The receipt becomes, as

[1] Allen *v.* Maury, 66 Ala. 10.

[2] Hazard *v.* Fiske, 83 N. Y. 287, 296.

[3] First Nat. Bank *v.* Bates, 1 Fed. Rep. 702; McNeil *v.* Hill, 1 Woolw. 96; Whitlock *v.* Hay, 58 N. Y. 484; Stewart *v.* Phœnix Ins. Co. 9 Lea, 104.

[4] McNeil *v.* Hill, 1 Woolw. 96.

between the pledgee, advancing money on the faith of its representations, and the warehouseman, a contract not to be explained or contradicted by parol, but to be enforced, upon breach, in favor of the innocent pledgee for value, who otherwise will suffer loss.[1] A warehouseman issued and delivered a receipt, "Received of A 5,000 bushels No. 2 white mixed corn, to be loaded into sacks, tickets for which, when loaded, will be sent down promptly." A took the receipt to a bank, and borrowed money on it as collateral. He then ordered the grain to be shipped, which was done by the warehouseman, who delivered the receipt received from the carrier to A, upon which he obtained a bill of lading. He again went to the same bank, and obtained a discount of a draft, attaching the bill of lading as collateral security, the bank having no notice that the same grain was covered by the receipt and bill of lading. The fraud being discovered, and the goods appropriated to meet the bill of lading, the warehouseman was estopped to set up any defense as to the receipt issued, to the injury of the pledgee advancing money in good faith upon the credit of the representations contained in the receipt.[2]

§ 417. No title acquired by Pledgee, with notice of fraud or felony.—The real owner of property who has been induced to deliver the actual possession of such property, or of the indicia of title, as a warehouse receipt, to a vendee, by reason of his fraudulent misrepresentations, may recover such property or indicia of title from one who is chargeable with notice of the fraud, or who has not made an advance or parted with consideration upon the faith of such possession of property or of documents of title, provided such owner or vendor asserts his title within a reasonable time, before the rights of innocent persons, pledgees for

[1] Stewart *v.* Phœnix Ins. Co. 9 Lea, 104.

[2] Union Savings Assn. *v.* St. Louis Grain Elev. Co. 11 Mo. App. 596.

value, have intervened.[1] The indefeasible title of the vendor of property represented by warehouse receipts, is not defeated, where the same are received by a bank as collateral for an overdrawn account, where the pledgee, a bank, is chargeable with notice that the sale of the property covered by such receipts had been made for cash, and there was enough to put a prudent person upon inquiry as to the title of the pledgor to the property. Where a check of the pledgor is given in payment, and payment is refused in the Clearing House, and upon the same day, upon another presentation by the vendor, a second refusal to pay is made, or to return the receipts, the unpaid vendor may bring an action of trover against the pledgee. Nor is it material that the pledgee holds only the indicia of title, the warehouse receipts, and not the property, as the receipts stand in the place of the property which they represent. The unpaid vendor is entitled to his action of trover against the pledgee, the damages to be the value of the goods.[2]

A pledgee of warehouse receipts can acquire no title, where he receives the same chargeable with notice, express or implied, that the use of such receipts as collateral security is a misappropriation by the person intrusted with the documents of title, or that the property described has never been received into the warehouse issuing such receipt, although such pledgee has advanced value. Under such circumstances, as where the unpaid vendor seeks to recover from a pledgee chargeable with notice of the non-payment of the purchase money, the pledgee takes only the title of his fraudulent assignor, which is, in fact, no title at all.[3] Nor can an innocent pledgee for value, who advances money upon a warehouse receipt which has been feloniously obtained by robbery or larceny, acquire any rights or title, where such receipts are not negotiable, as against the real

[1] Barnard *v.* Campbell, 58 N. Y. 73; Root *v.* French, 13 Wend. 573; Mowry *v.* Walsh, 8 Cow. 238; Hoffman *v.* Noble, 6 Met. 68.

[2] Canadian Bank *v.* McCrea, 106 Ill. 281.

[3] Merchants' Bank *v.* Colt, 15 Barb. 506; Whitlock *v.* Hay, 58 N. Y. 484.

owner. Receipts were issued payable to "bearer," and the pledgee inquired of the party issuing the same if they were good, and was told they were. The receipts were unindorsed, and therefore not negotiable under a statutory provision requiring indorsement in every case. The receipts were pledged by a clerk who had stolen the same, and in an action for the possession of the goods, as between the real owner and the pledgee, the title of the former was preferred.[1] Nor is a pledge of warehouse receipts by a factor, unauthorized and in violation of his duty, supported, as against his principal, although the recovery will be subject generally to a recoupment in favor of the pledgee to the extent of the valid lien of the factor.[2] The pledgee of warehouse receipts, except where the same are made negotiable, can acquire no greater rights than his assignor, where the transfer is made by one without authority or in violation of a statute.[3] And a pledgee of warehouse receipts, the goods being unidentified, and part of a much larger quantity, is entitled to no preference over holders of other receipts.[4]

§ 418. PLEDGES SUPPORTED UPON DELIVERY OF RECEIPT AND POSSESSION.—Where goods are stored in the warehouse of a third person, the indorsement and delivery of the receipt therefor by the owner to a pledgee, and notice of the transfer to the warehouseman (especially if the latter assents), makes him agent for the pledgee, and is a good constructive delivery, because it changes the possession and dominion.[5] A warehouse entry having been made at a cus-

[1] Erie & Pac. Dispatch Co. *v.* Compress Co. 6 Mo. App. 175; Fourth Nat. Bank *v.* Compress Co. 11 Ib. 333.

[2] First Nat. Bank *v.* Bryce, 78 Ky. 42; Merchants' Nat. Bank *v.* Trenholm, 12 Heisk, 520.

[3] People's Bank *v.* Gayley, 12 Phila. 183; aff. 92 Pa. St. 518; Erie & Pac. Disp. Co. *v.* Compress Co. 6 Mo. App. 175; Fourth Nat. Bank *v.* Compress Co. 11 Ib. 333.

[4] Sawyer *v.* Taggart, 14 Bush, 727; May *v.* Hoagland, 9 Ib. 172.

[5] DeWolf *v.* Gardner, 12 Cush. 19.

tom house, a receipt was issued entitling the holder to withdraw the goods. The transfer of the receipt as collateral security vested the title to the property and the right of possession in the pledgee. Receiving the indicia of title in good faith, for value and without notice, the pledgee is not chargeable with notice of the contents nor required to inspect the warehouse registry before advancing his money upon the faith of the representations of the receipt.[1] Placing goods in a cellar of the warehouse of the pledgor, hired for the purpose by the pledgee, is a sufficient delivery.[2] Where property is stored in a warehouse, and receipts issued therefor, to a person who advances money in good faith under a special contract, providing, among other things, that the property shall in case of flood be at the risk of the "owner," the transaction is a pledge, and not a mortgage, there being no transfer of the title. The pledgee is not the "owner," nor the goods at his risk.[3] The title of a pledgee of warehouse receipts, taken as collateral security for advances, who had entered into possession of the property, surrendering the receipts, and then left the same with the pledgor so that the property might be shipped at once on account of the pledgee, is not affected by an attempt of a creditor of the pledgor to levy upon the property while in process of shipment. Having obtained actual possession, the re-delivery of the receipts for the purpose of shipment, or other special purpose, was allowable.[4]

§ 419. Possession, actual or implied, necessary to valid Pledge.—A factor, having property belonging to his principal stored in his building, obtained a loan from a bank for his own purposes, upon giving a receipt stating that such property had been placed "in the control and possession of said bank, to be used by said bank as its property for

[1] Cartwright *v.* Wilmerding, 24 N. Y. 521.

[2] Sharp *v.* Philadelphia Warehouse Co. 9 Rep. 572.

[3] Bank of B. Columbia *v.* Marshall, 11 Fed. Rep. 19, 26.

[4] Nelson *v.* McIntyre, 1 Bradw. 603.

the re-imbursement of the loan, and if paid when due, or before said property is disposed of by the said bank for its re-imbursement, then to be returned unto" the pledgor. As against the owner, the pledge was not sustained, there being a want of possession, and the pledgee being chargeable with constructive notice that the pledgor was a factor, whose duty was to sell, and who had no authority to pledge for a loan to himself individually.[1] And where a receipt was issued by a custodian, without authority so to do, and the same, indorsed, was delivered by an agent to a person who advanced funds in good faith, upon the representations of such receipt, the transfer, although sustained as against the principal, was defeated as against bona fide purchasers for value from the principal who had obtained possession of the goods upon valid receipts.[2] Where indorsement of warehouse receipts to transfer title is required by a statute, a mere equitable title is received by a pledgee receiving receipts unindorsed, as though he were a pledgee without possession. Such title is subject to be defeated by a sale to a bona fide purchaser for value, without notice of the pledge.[3] And where a pretended warehouse receipt is executed by a debtor to his creditor of property as security, the property remaining in the possession of the debtor, who is not a warehouseman, the receipt is void as against other creditors obtaining liens by legal process.[4]

§ 420.—Pledge by Warehouseman of receipts for his own property.—In the absence of statutory enactment, a warehouseman having property of his own in his warehouse, may issue receipts therefor, as in other cases, and vest title to the property in other persons by the transfer of such receipt, by indorsement and delivery, or by the delivery of receipts made directly in the name of the person

[1] First Nat. Bank *v.* Nelson, 38 Geo. 391.

[2] People's Bank *v.* Gayley, 12 Phila. 183; aff. 92 Pa. St. 518.

[3] Troutman *v.* People's Bank, 12 Phila. 276; People's Bank *v.* Gayley, 12 Ib. 183; s. c. 92 Pa. St. 518.

[4] Thorne *v.* Bank, 37 Ohio St. 254.

to whom the property is to be transferred. A warehouseman may use such receipts as collateral to secure the payment of loans to himself or his own indebtedness.[1] It is no objection that the warehouse receipt thus issued is the vendor's or pledgor's own receipt, or that he still remains in possession of the property. The fact of giving such receipt converts the vendor into a warehouseman, and such holding of possession in another capacity is a good delivery. The title of a pledgee for value advanced upon a receipt so issued, is sustained as between the parties.[2] A receipt for property stored in the yard of the debtor, not strictly a warehouse receipt within the terms of the law, was given as collateral for a loan, made in good faith. The pledgee subsequently learning of the impending insolvency of the debtor, took actual possession of the property, and the legal title thus obtained was sustained as against the pledgor, and his assignee in bankruptcy.[3]

§ 421.—The Warehouseman as Pledgor, under statutory enactments.—The right of a warehouseman to issue receipts for collateral security upon his own property, is made the subject, in a few states, of statutory regulation. In cases arising in these states, the terms of the statutes control. Such receipts are required generally to be issued only "for a consideration," which is construed as prohibiting the issue of receipts by warehousemen upon their own property. The warehouseman remaining in possession of the property, no contract of pledge can be made. Such receipts, not being within the statute, and being invalid, their use as collateral security for a loan to the warehouseman is not supported, as against judgment creditors, or assignees in in-

[1] Merchants' Bank *v.* Hibbard, 48 Mich. 118; Cochran *v.* Rippey, 13 Bush, 495; Greenbaum *v.* Megibben, 10 Ib. 419; Broadwell *v.* Howard, 79 Ill. 305; Cool *v.* Phillips, 66 Ib. 270; Parshall *v.* Eggert, 54 N. Y. 18, 21; Horn *v.* Barker, 8 Cal. 614; National Bank *v.* Walbridge, 19 Ohio St. 424; Shephardson *v.* Cary, 29 Wis. 24, 43.

[2] DeWolf *v.* Gardner, 12 Cush. 19.

[3] Sherman *v.* Traders' Nat. Bank, 9 Biss. 216.

solvency.[1] This rule was applied where the owner of property stored in a manufactory of which he was the owner, but which had its distinctive name, procured the superintendent to issue a receipt for property, upon the indorsement of which as collateral a loan was obtained from a bank. No possession was taken, nor was the receipt recorded; and an execution was levied upon the property by a creditor of the owner. He subsequently sold some of the property, on account of the bank, to a purchaser for value without notice; but the property was re-taken by the officer. Upon an action against the officer, the levy was sustained. As between the parties the receipt was a nullity; and as against third parties, the want of change of possession, notwithstanding a pretended secret change of ownership, and the failure to record the assignment, defeated the title of the pledgee.[2] In Iowa, a warehouseman is not allowed, by statutory enactment, to issue receipts upon his own property for the purpose of using the same as collateral security.[3] The same statute is in force in Ohio, but a distinction as to its application was taken where advances had been made, under a contract, made previously and still subsisting, for the purchase by a warehouseman of property, to be stored in his warehouse, the warehouse receipts being issued in the name of the party advancing the money, who upon the sale of the property was to retain the amount of his advances and commissions. Warehouse receipts issued in good faith under such a contract, are supported as against legal process by creditors of the warehouseman. The legal title and right to possession having passed to the party making advances in good faith, the merely equitable interest of the warehouseman in the proceeds was not subject to legal process.[4]

[1] Adams *v.* Merchants' Nat. Bank, 9 Biss. 396; In re Gurney, 7 Ib. 414; Miller *v.* Jones, 15 N. B. R. 150; Allen *v.* Massey, 17 Wall. 351.

[2] Yenni *v.* McNamee, 45 N.Y. 614.

[3] Sexton *v.* Graham, 53 Iowa, 181; Iowa code, §2171; Yenni *v.* McNamee, 45 N. Y. 614, construing the New York statute to like effect.

[4] Gibson *v.* Chillicothe Bank, 11 Ohio St. 311.

PART V.

NON-NEGOTIABLE COLLATERAL SECURITIES.

CHAPTER XLIV.

CHOSES IN ACTION AS COLLATERAL.

§422. Non-negotiable choses and equitable assignments as collateral security.
423. Equitable assignments of funds as collateral.
424. Assignments in part of such securities.
425. The pledge of non-negotiable collaterals, with or without indorsement.
426. The assignment in pledge of insurance policies.
427. The pledgee's lien, upon payment of premiums.
428. Pledges of non-negotiable collaterals, without notice to debtor.
429. Priority of assignees of funds, upon giving notice.
430. The debtor's liability, with notice of assignment.
431. No title acquired by pledgees, with notice of fraud.

§ 422.—Non-negotiable choses and equitable Assignments as Collateral Security.—The use of non-negotiable choses in action and equitable assignments of funds as collateral security, including the pledge of insurance policies, leases, interests under wills, orders on funds, equitable assignments of part interests, city and other certificates, savings bank books, chattel mortgages, memberships of stock exchanges, unpaid calls on stocks, interests under

contract, and other choses in action, affords the pledgee less available security than either negotiable or quasi-negotiable collateral securities. Unless the pledgor or owner has, by his affirmative acts or omissions, or neglects, brought himself within established rules relative to equitable estoppel, a pledgee receiving such non-negotiable choses in actions or equitable assignments of funds as collateral security, for a valuable consideration, in good faith, holds them subject to all equities existing at the time of the transfer,[1] and to all defenses valid as to the original parties.[2] The non-negotiable chose in action itself is open to all equities, and subject to all defenses growing out of the original transaction, in the hands of any assignee, however remote.[3]

The pledgee of a non-negotiable chose in action is, however, not subject to equities or rights arising subsequently to its assignment;[4] nor to equities arising from other and independent transactions between the original parties;[5] nor in a case of an assignment of a judgment, will an equity be allowed when not asserted by one of the parties to such judgment, or his assignee or representative.[6] The only fraud, as to the instrument, permissible to be shown at law

[1] Harter *v.* Coleman, L. R. 19 Ch. D. 630, 634; Watson *v.* Mid Wales Ry. Co. L. R. 2 C. P. 593; Cowdrey *v.* Vandenbrough, 101 U. S. 522; Judson *v.* Corcoran, 17 How. 612; Wickham *v.* Morehouse, 16 Fed. Rep. 324; Bush *v.* Lathrop, 22 N. Y. 535; Ingraham *v.* Disborough, 47 Ib. 421; Baker v. Bishop Hill Colony, 45 Ill. 264; Irish *v.* Sharp, 89 Ib. 26; Chickering *v.* Fullerton, 90 Ib. 520; Jasper County *v.* Tavis, 76 Mo. 13; Cutts *v.* Gould, 57 N. Y. 229; Storey *v.* Dutton, 46 Mich. 539; Davis *v.* Beckstein, 69 N. Y. 442.

[2] Moore *v.* Metropolitan Nat. Bank. 55 N. Y. 41; Wickham *v.* Morehouse, 16 Fed. Rep. 324; People *v.* Johnson, 100 Ill. 537; Davis *v.* Beckstein, 69 N. Y. 442; Combes *v.* Chandler, 33 Ohio St. 178; Burtis *v.* Cook, 16 Ia. 194; Isett *v.* Lucas, Ib. 507; In re Agra Bank, L. R. 2 Ch. 39, 397; Graham *v.* Johnson, L. R. 8 Eq. 36; Piper *v.* Piper, L. R. 1 Ch. D. 90; Ord *v.* White, 3 Beav. 357.

[3] Trustees of Union College *v.* Wheeler, 61 N. Y. 114; Cutts *v.* Guild, 57 Ib. 229; Combes *v.* Chandler, supra; Ord *v.* White, 3 Beav. 357.

[4] George *v.* Tait, 102 U. S 564; Harter *v.* Coleman, L. R. 19 Ch. D. 630.

[5] Isett *v.* Lucas, 19 Iowa, 507; Clark *v.* Roberts, 25 Hun. 26.

[6] Isett *v.* Lucas, supra.

against a bona fide pledgee for value, without notice, is fraud touching the execution, such as misreading, the surreptitious substitution of one paper for another, or the obtaining by some other trick or device of an instrument different from that intended by the party executing the same;[1] and an equitable defense, founded upon the original transaction, may be defeated as against an innocent pledgee for value, by negligence even less than gross, if it be the cause of his advance.[2]

§ 423. EQUITABLE ASSIGNMENTS OF FUNDS AS COLLATERAL.—Equitable assignments of funds or choses in action are supported. Where certain property was pledged to secure the holders of bills of exchange, and upon sale to be applied in their payment, the letters which passed between the parties, without a formal contract, being sufficient as an appropriation to entitle the holders of the bills of exchange to maintain an action for the proceeds.[3] The like rule was applied where an equitable assignment of debts due by third persons to the acceptor was made to secure the holders of bills of exchange. Notice was given of the assignment, and the bills were discounted, the acceptor subsequently becoming insolvent. The proceeds of the debts thus equitably assigned were paid to the holders of the bills of exchange.[4] A voluntary equitable assignment of a chose in action, with delivery, when made in good faith, and creditors are unaffected, cannot be defeated by a subsequent assignee, although paying value.[5] Insurance policies having been deposited as collateral security, and a sub-pledge made of the policies and other securities upon a bona fide advance, an equitable assignment by the pledgee of any balance of the proceeds of such policies and securities for the benefit

[1] George *v.* Tait, 102 U. S. 564; Hartshorn *v.* Day, 19 How. 211; Osterhout *v.* Shoemaker, 3 Hill, 513; Belden *v.* Davis, 2 Hall, 433; Franchot *v.* Leach, 5 Cow. 506.

[2] Feltz *v.* Walker, 49 Conn. 93.

[3] Rankin *v.* Alford, L. R. 5 Ch. D. 786.

[4] In re Mann, L. R. 5 Ch. D. 367.

[5] Beal *v.* Warren, 2 Gray, 447.

of a bank making advances thereon, with notice to the sub-pledgee, created a valid lien in favor of the bank upon the surplus of the proceeds from the insurance policies and other collaterals.[1]

A letter to the effect that "I hereby undertake that I will, when and as received, pay over to you all dividends coming to me in respect of my proof upon the estate of X," when accepted, and consideration given, is a good equitable assignment of the entire dividends. The assignor himself became bankrupt, and the assignee then gave notice of his claim to the trustees in the bankruptcy in which the dividends were to be declared. His claims were preferred to the trustees in bankruptcy of the assignor.[2] But a bankrupt while undischarged, having no interest in the surplus beyond a mere hope or expectancy, cannot give an assignee of such surplus any right to interfere in the administration of the estate.[3] A mere promise in writing, or parol, to pay a debt out of a distinctive fund, although it be of the clearest and most solemn kind, will not give the promisee an equitable lien on the fund nor be sufficient to operate as an equitable assignment. Where the holder retains control so that he may collect the fund or recall his promise, the right to a present and complete control does not exist on the part of the assignee, and no benefit can accrue to him.[4]

§ 424. Assignments in part of such Collaterals.— The claims of a pledgee of non-negotiable choses in action or of equitable assignments of funds, where but a part or portion is assigned, is supported in equity. All persons interested in such choses in action or funds should be made parties

[1] Meyers *v.* United Guaranty Co. 7 DeG. M. & G. 112.

[2] In re Irving, L. R. 7 Ch. D. 419.

[3] Ex parte Sheffield, L. R. 10 Ch. D. 434.

[4] Christmas *v.* Russell, 14 Wall. 69; Trist *v.* Child, 21 Ib. 441; Hull *v.* Jackson, 20 Pick. 197; Rogers *v.* Hosack, 18 Wend. 319; Williams *v.* Ingersoll, 89 N. Y. 518; Christmas *v.* Griswold, 8 Ohio St. 558; Hopkins *v.* Beebe, 26 Pa. St. 85; Malcolm *v.* Scott, 3 Hare, 46; Field *v.* Megaw, L. R. 4 C. P. 660.

thus avoiding a multiplicity of suits by different claimants and enabling the debtor to obtain a judicial distribution of the securities and funds in his possession. The equity of the assignee of part only of an equitable fund or chose in action is as deserving of protection in a court of chancery as where an absolute assignment of the whole has been made, subject to the equitable rule that such part claim can be separately protected and enforced without injury or loss to the debtor.[1] An order given granting a part assignment of a fund to be settled by arbitration and pledged as collateral security, although the amount of the fund had not then become definitely settled, operated as an equitable transfer, although the fund had a potential existence only at the time of the assignment.[2] Such part assignment should be drawn against a particular fund, and not against a debtor in general terms.[3] But for special reasons, the rule is not *semble* applied to part assignments of non-negotiable choses in action issued by municipalities.[4]

In courts of law, no recovery can be had upon part assignments of non-negotiable choses in action or equitable funds. The creditor if he were allowed to split up his cause of action into parts, or as might be the case, sub-divide it in-

[1] Christmas *v.* Russell, 14 Wall. 69; Trist *v.* Child, 21 Ib. 441; Dowell *v.* Cardwell, 4 Sawyer, 217; Daniels *v.* Menihard, 53 Ga. 359; Lapping *v.* Duffy, 47 Ind. 51; Wood *v.* Wallace, 24 Ib. 226; Etheridge *v.* Vernoy, 74 N. C. 809; Exchange Bank *v.* McLoon, 73 Me. 498; Whitney *v.* Cowan, 55 Miss. 626; Christie *v.* Sawyer, 44 N. H. 298; Public Schools *v.* Heath, 15 N. J. Eq. 22; Morton *v.* Naylor, 1 Hill, 583; Bradley *v.* Root, 5 Paige, 632; Risley *v.* Phoenix Bank, 83 N. Y. 318; City of Philadelphia's App. 86 Pa. St. 79; Claflin *v.* Kimball, 52 Vt. 6; Wellsburg Bank *v.* Kimberlands, 16 W. Va. 555; Ex parte South, 3 Swanst. 392; Thompson *v.* Simpson, L. R. 5 Ch. 659; Addison *v.* Cox, 8 Ib. 76; Ranken *v.* Alfaro, L. R. 5 Ch. D. 786; Ex parte Hall, 10 Ib. 615; and at law, Brown *v.* Bateman, L. R. 2 C. P. 272; Field *v.* Megaw, 4 Ib. 660; Price *v.* Bannister, L. R. 3 Q. B. D. 569; Tibbetts *v.* George, 5 A. & E. 107.

[2] Wellsburg Bank *v.* Kimberlands, 16 W. Va. 555.

[3] Exchange Bank *v.* McLoon, 73 Me. 498.

[4] City of Philadelphia's App., 86 Pa. St. 179; Jermyn *v.* Moffit, 75 Pa. St. 399; Mandeville *v.* Welch, 5 Wheat. 277.

definitely, might subject his debtor to embarassments and responsibilities not contemplated by the original contract. Nor will the debtor be required to ascertain and decide at his peril as to the relative title and rights of part assignees of any equitable fund, or of any claim arising out of or to a chose in action. The assignee of a non-negotiable chose in action is at the common law, and still is, in law courts, unless the rule has been changed by statutory or code enactments, required to sue in the name of his assignor.[1]

§ 425. The Pledge of non-negotiable Collaterals, with or without indorsement.—The transfer of non-negotiable choses in action as collateral security for a loan or discount is valid, whether with or without indorsement. Indorsement is not generally required in order to vest in the pledgee for value all the title that he can acquire in such choses in action. Except where required by the terms of the instrument, indorsement is not usually necessary. The intention of the parties to pass the title to choses in action will control, although no indorsement has been made. An equitable lien may be created by parol.[2] The delivery of a savings bank without indorsement or assignment, as collateral security, conveys an equitable title to the deposits, which is preferred as against legal process subsequently issued by a creditor.[3] A delivery of a certificate of deposit issued by a bank and made payable to a certain named person, "or his order, upon the return of this certificate properly indorsed," is sufficient, under provisions of statutes

[1] Mandeville *v.* Welch, 1 Wheat. 233; s. c. 5 Wheat. 277; Tierman *v.* Jackson, 5 Vt. 580; Creighton *v.* Hyde Park, 6 Bradw. 273; Robbins *v.* Bacon, 3 Greenl. 346; Stanberry *v.* Smythe, 13 Ohio St. 495; Gibson *v.* Cooke, 20 Pick. 15; Palmer *v.* Merrill, 6 Cush. 282; Tripp *v.* Brownell, 15 Ib. 376; Bullard *v.* Randall, 1 Gray, 605.

[2] Thayer *v.* Daniels, 113 Mass. 129; Kingman *v.* Perkins, 105 Ib. 111; Dix *v.* Cobb, 4 Ib. 508, 512; Williams *v.* Ingersoll, 89 N. Y. 518; Stout *v.* Yaeger Co., 13 Fed. Rep. 802.

[3] Taft *v.* Bowker, 132 Mass. 277; Pierce *v.* Boston Savings Bank, 129 Ib. 425; Kingman *v.* Perkins, 105 Ib. 111.

relating to suits being brought by the real parties in interest, to entitle the person advancing money upon such securities to bring an action in his own name.[1] Such certificates of deposit issued by banks assimilate to negotiable paper, the legal title only passing upon indorsement and delivery; and in the absence of statutory enactment, the security is made more effective by indorsement than by delivery merely.[2] A written assignment and delivery of profits of a contract for building a public road was required for the same reason, the rendering of the security the more available to satisfy the debt upon default.[3] And a legal title was acquired to deposits in a savings bank by an indorsement on the book, as against an equitable title obtained by delivery without indorsement.[4] A pledgee advancing money upon the credit of the apparent ownership of a person holding scrip certificates for money indorsed in blank, without notice of equities, obtains a good title against the owner.[5] The delivery of choses in action is an essential condition of a pledge thereof.[6]

§ 426. The Assignment in pledge of Insurance policies.—Indorsement as well as delivery is required of insurance policies, either fire or life, where payable to a certain named person "or assigns," in order to render them effectual as collateral security for an advance.[7] Where a deposit had been made of an insurance policy as collateral security for a loan, upon an agreement to make a formal indorsement, but the pledgor died before its execution,

[1] Cassidy *v.* First Nat. Bank, 30 Minn. 86; Pease *v.* Rush, 2 Ib. 107; Beal *v.* Warren, 2 Gray, 447.

[2] International Bank *v.* German Bank, 71 Mo. 883; Cassidy *v.* First Nat. Bank, supra; Klauber *v.* Biggerstaff, 47 Wis. 551; Pardee *v.* Fish, 60 N. Y. 265.

[3] Gay *v.* Moss, 36 Cal. 125; Dewey *v.* Bowman, 8 Ib. 151.

[4] Combes *v.* Chandler, 33 Ohio St. 178; Weirick *v.* Bank, 16 Ib. 296.

[5] Baldwin *v.* Ely, 9 How. 580.

[6] Whipple *v.* Whipple, 109 Ill. 418; Hart *v.* Forbes, 60 Miss. 746.

[7] Shearman *v.* Niagara Fire Ins. Co. 46 N. Y. 526; Merrifield *v.* Baker, 11 Allen, 43; City Bank *v.* Ass. Co. 32 W. R. 658.

equity relieved the pledgee by a decree for the payment by the company to him of the amount due with interest, without a formal assignment.[1] An equitable title is acquired to policies of insurance pledged as collateral security by delivery merely, such being the mutual intention of the parties;[2] and an equitable pledge of a surplus arising from a policy is sustained, upon notice to the pledgee.[3] The use as collateral security of insurance policies, upon bona fide loans, vests in the pledgee the legal title, as upon an absolute assignment. Receiving such title, he may enforce the security to its full amount, holding any surplus after payment of his advances, premiums and assessments paid, for the pledgor or persons equitably entitled thereto.[4] But no enforcement is allowed the pledgee, although advancing value, upon assignments of policies obtained merely for speculative purposes, such policies being illegal and void.[5] A clause in a policy prohibiting assignments without the consent of the insurance company does not apply to a pledge.[6] A creditor, who had been promised an insurance policy as collateral security for an advance, and by negligence failed to obtain it before the pledgor's death, was not allowed to claim privilege under the Louisiana code.[7] A prior pledgee, with possession, is preferred in equity.[8]

[1] Crossley *v.* Ins. Co. 4 Ch. D. 421; Webster *v.* Ins. Co. 15 Ib. 169.

[2] Soule *v.* Bank, 45 Barb. 111; West *v.* Ins. Co. 31 Ark. 476; Bruce *v.* Gardner, L. R. 5 Ch. 32; Edwards *v.* Martin, L. R. 1 Eq. 121; Latham *v.* Bank, 17 Ib. 205; Stout *v.* Yaeger Co. 13 Fed. R. 802; Chapman *v.* McIlrath, 77 Mo. 39; Hart *v.* Forbes, 60 Miss. 29; Williams' App. 15 W. N. C. 89.

[3] Myers *v.* Guarantee etc. Co. 7 DeG. M. & G. 112; City Bank *v.* Ass. Co. supra; Diffenbach *v.* Vogeler, 61 Md. 370.

[4] Warnock *v.* Davis, 104 U. S. 775; O'Mara *v.* Nugent, 37 N. J. Eq. 324; Ins. Co. *v.* Coffee, 61 Tex. 287; Ins. Co. *v.* Garland, 108 Ill. 220; Olmsted *v.* Keyes, 85 N. Y. 593; Gilbert *v.* Moose, 13 W. N. C. 489; Fairchild *v.* Life Assn. 51 Vt. 625; Gilman *v.* Curtis, 64 Cal. (16 C. L. N. 217).

[5] Rombach *v.* Ins. Co. 35 La. Ann. 233; Stokell *v.* Kimball, 59 N. H. 13; Stevens *v.* Warren, 101 Mass. 251; Johnson *v.* Van Epps, 14 Bradw. 201; Warnock *v.* Davis, supra.

[6] Ellis *v.* Kreutzinger, 27 Mo. 311; Spare *v.* Ins. Co. 17 F. R. 568; Powers *v.* Ins. Co. 136 Mass. 108.

[7] Succ. D'Meza, 26 La. Ann. 35.

[8] Spencer *v.* Clarke L. R. 9 Ch. D. 137; Diffenbach *v.* Vogeler, supra.

§ 427. THE PLEDGEE'S LIEN, UPON PAYMENT OF PREMIUMS.—A lien enforcible in equity may be created upon the moneys secured by an insurance policy by payment of premiums, where they are paid under a contract with the beneficial owner. The sureties of a mortgagor who has contracted with a mortgagee to pay the premiums on an insurance policy as a collateral security, who have paid such premiums upon default of their principal, are given a lien upon the moneys realized from the insurance policy held as security.[1] Such lien upon insurance policies as collateral, may also be acquired by trustees who have advanced money for the preservation of the trust property, and by other persons who have loaned funds bona fide, upon request of trustees, for the like purpose.[2] The claim of persons advancing money to pay premiums on insurance policies at the request of trustees, is not defeated by reason of the fact that the trustees who obtained the loan might possibly have taken some other course to obtain a fund for the preservation of the trust property.[3] Payments of premiums upon insurance policies made by a stranger, or by an owner in part of such policies, are not sufficient to create a lien upon the insurance moneys, unless the owner stands by during such payments, and allows the same to be expended in preserving his property.[4] An owner of insurance policies, as a part of a transaction voidable for fraud, assigned the same as collateral security for moneys advanced, covenanting to pay the premiums to keep them alive. The pledgee paid some of the premiums after the assignment. The pledgor instituted a suit to set aside the transaction as being voidable by reason of fraud, but was only given relief as to the premiums paid, as by the

[1] In re Leslie, L. R. 23 Ch. D. 552; Warnock *v.* Davis, 104 U. S 775; Scobey *v.* Waters, 10 Lea, 551· Harley *v.* Heist, 86 Ind. 196.

[2] Clack *v.* Holland, 19 Beav. 262; Todd *v.* Moorhouse, L. R. 19 Eq. 69.

[3] Todd *v.* Moorhouse, supra.

[4] Norris *v.* Caledonian Ins. Co. L. R. 8 Eq. 127; In re Leslie, Leslie *v.* French, L. R. 23 Ch. D. 552, 565; Burridge *v.* Row, 1 Y. & C. Ch. 183; Clack *v.* Holland, 19 Beav. 262; Pinkett *v.* Wright, 2 Hare, 120; 12 Cl. & F. 764.

assignment as security the pledgee had become a part owner the policies, and had no lien for such payments. The title of the pledgee, however, was fully protected to the amount of the moneys actually advanced, the assignment of the policies being a valid security to that extent.[1] An insurance policy on the life of a third person was assigned by the equitable owner as collateral security for the payment of certain legacies, the pledgor covenanting to pay the premiums. After his decease, his executor continued the payments. The payments of premiums being by a part owner and his representative, created no lien on the insurance policies, as against the legatees.[2]

§ 428. Pledge of non-negotiable Collaterals, without notice to Debtor.—A pledgee for value, without notice, of non-negotiable collaterals, which are in the form of documents or indicia of title, receiving the same indorsed, where required, or by delivery, is protected as against creditors of the debtor, or subsequent assignees of the same security, although he has given no notice of the assignment to the person who is liable.[3] Under this rule, supporting the equitable title of an assignee of a non-negotiable chose in action, receiving the documents of title, as against later pretended assignments of the same collateral security, it is immaterial that the second assignee acquired his interest under such pledge in good faith and for value.[4] Creditors of the debtor are subject to the rights acquired under such pledge, although no notice be given to the debtor, and the assignment of the chose in action is by

[1] Pennell *v.* Millar, 23 Beav. 172.

[2] In re Leslie, L. R. 23 Ch. D. 552.

[3] Muir *v.* Schenk, 3 Hill, 228; Greenstock *v.* Rosenback, 61 N. Y. 583; Freund *v.* Importer's Bank, 76 Ib. 352; Williams *v.* Ingersoll, 89 Ib. 518; Dix *v.* Cobb, 4 Mass. 508, 512; Richards *v.* Smith, 9 Gray, 315; Martin *v.* Potter, 11 Gray, 37; Kingman *v.* Perkins, 105 Mass. 111; Thayer *v.* Daniels, 113 Ib. 129; United States *v.* Vaughan, 3 Binn. 394; Stevens *v.* Stevens, 1 Ashmead, 190.

[4] Muir *v.* Schenck, 3 Hill, 228.

delivery merely.[1] Notice to an insurance company of the assignment of a policy, where the pledgee never received possession of the document of title, is of no avail as against a second pledgee, advancing money upon an indorsement and delivery of the policy, in good faith and without notice of the previous pledge.[2] The early rule in England, under which, as between bona fide assignees of the same non-negotiable chose in action, the one giving notice to the debtor was preferred, although becoming a holder for value without notice subsequently,[3] has been overruled. The equitable claim of the bona fide assignee, for value, having priority in point of time, although he has given no notice to the debtor, is preferred.[4] A minor's interest under a will is assignable, and although unrecorded, and without notice to the person holding the fund, the rights of a bona fide assignee advancing value are preferred as against the claims of a subsequent assignee, who had both recorded his assignment and given notice to the trustee.[5]

§ 429.—Priority of Assignees of Funds, upon giving notice.—Upon an equitable assignment of an interest in funds in the hands of debtors, or third parties, or trustees, or only potentially existent, the assignments being made by independent instruments, notice should be given by assignees to such debtors, or trustees, or third persons, within a reasonable time. As between the immediate parties to an assignment, no notice to the debtor or trustee is required; but

[1] Taft *v.* Bowker, 132 Mass. 297; Norton *v.* Piscataqua Ins. Co. 111 Ib. 532; Thayer *v.* Daniels, 113 Ib. 129; Kingman *v.* Perkins, 105 Ib. 111; Martin *v.* Potter, 11 Gray, 56; Lewis *v.* Trader's Bank, 30 Minn. 134.

[2] Spencer *v.* Clarke, L. R, 9 Ch. D. 137.

[3] Watts *v.* Porter, 3 E. & B. 743; Dearle *v.* Hall, 3 Russ. 1; Loveridge *v.* Cooper, Ib. 60; Mangles *v.* Dixon, McN. & G. 437; Foster *v.* Blackstone, 1 M. & K. 297; Meux *v.* Bell, 1 Hare, 73.

[4] Pickering *v.* Ilfracombe Ry. Co. L. R. 3 C. P. 235; Robinson *v.* Nesbitt, L. R. 3 C. P. 264; Beavan *v.* Oxford, 6 DeG. M. & G. 492; Kinderley *v.* Jervis, 23 Beav. 1.

[5] Putnam *v.* Story, 132 Mass. 205; Thayer *v.* Daniels, 105 Ib. 139.

the assignee, in order to protect his title against subsequent assignees of the same equitable interest in such funds, for value, without notice, and who have honestly made inquiries as to the title, should give reasonable notice of his claims to the debtor or trustee. A failure to give such notice, by reason of which an innocent assignee has been deceived into advancing value for a second assignment of the same interest from the assignor, will defeat the claim of the prior assignee, although he has advanced value, where notice to the debtor or trustee of his assignment has been given by the second assignee. The latter stands in a better position than the first assignee, having acquired by notice the legal as well as the equitable title to the fund assigned.[1] An assignee for value of a legal title from a real owner, with a valid title of record, is not chargeable with notice by the registry of an equitable title, although a subsequent assignee of such equitable interest from the same grantor is.[2]

§ 430.—The Debtor's liability, with notice of Assignment.—Debtors bound upon non-negotiable choses in action, or trustees holding equitable funds, who are chargeable with notice of the transfer to the assignee, are equitably required to abstain from doing or omitting any act which may result to the prejudice, loss or damage of the rights and interests of such assignee for value, in good faith. Any payments, or compromises, or settlements made by a debtor with the assignor or other parties, after notice of such assignment, and without consent of the assignee, are fraudulent and void, and afford no defense to an action by the assignee.[3] The assignee for value, without notice, of a non-negotiable document of title, is protected as against credi-

[1] Judson *v.* Corcoran, 17 How. 280; Murray *v.* Lylburn, 2 Johns. Ch. 442; Moore *v.* Holcombe, 3 Leigh, 597.

[2] Tarbell *v.* West, 86 N. Y. 280; Bentley *v.* Bates, 4 Y. & C. 190.

[3] Creighton *v.* Hyde Park, 6 Bradw. 274; Carr *v.* Waugh, 28 Ill. 418; Morris *v.* Cheney, 51 Ib. 451; Littlefield *v.* Story, 3 Johns. 426; Field *v.* Mayor, 7 N. Y. 179.

tors of the debtor and subsequent assignees of the same chose in action, although no notice has been given of such assignment. Notice, however, should be given to the debtor to defeat a subsequent bona fide payment made by him to the creditor.[1] Fraudulent releases of choses in actions or equitable funds by the creditor after assignment and notice to the debtor or trustees, are of no effect as against a bona fide assignee for value advanced.[2]

§ 431.—No title acquired by Pledgees, with notice of fraud.—A pledgee of a non-negotiable security, chargeable with notice, express or implied, that such use is an act of fraud or misappropriation, can acquire no right to be protected in equity, nor any better title to such collateral than the pledgor. A trust company issued a non-negotiable receipt for certain bonds, the receipt being in the name of a third person as "trustee." Authority was given to use the receipt as collateral security for a certain sum, but it was fraudulently pledged to secure more than twice the amount. Learning of the misappropriation, a tender was made of the amount authorized, and demand for the receipt. Chargeable with notice by the terms of the receipt, the pledgee was bound to inquire of the cestui que trust whether the transaction was authorized; failing to do so, he must bear the loss resulting from his negligence.[3] Notice of the restricted rights of a pledgee, holding a lease as security for the payment of a negotiable note, is sufficient to defeat an assignee of the interest of the pledgee when attempting to claim greater rights than those of his assignor.[4] A pledgee can acquire no interest under an assignment of a judgment, taken against a putative father in a bastardy case to provide for the maintenance of the child, in custody of a guardian, made by the mother as collateral security for her individual

[1] Williams *v.* Ingersoll, 89 N. Y. 518.

[2] Andrews *v.* Becker, 1 Johns. Cas. 411.

[3] Swan *v.* Produce Bank, 24 Hun. 277.

[4] Dewey *v.* Bowman, 8 Cal. 145.

debt, when chargeable with notice of the misappropriation.[1] Nor can a pledgee acquire any title as against the real owner in a case where a trustee borrows money for his own use, assigning an order or decree in favor of the trust estate as collateral security for its repayment, the pledgee being chargeable with knowledge of the misappropriation.[2] Upon a wrongful pledge by an agent, however general his powers, of a judgment owned by his principal, as collateral security for a loan by a bank to himself, the principal note being signed as "agent and attorney," the pledgee, being chargeable with the duty of inquiring as to the extent of the authority given, upon failure so to do, can acquire no valid claim against the real owner of the judgment.[3] Notice is not presumed as against a bona fide pledgee for value, where land certificates, and transfers indorsed in blank, properly acknowledged, having been deposited with an agent for safe keeping and for sale, were fraudulently pledged by him as collateral security for an advance made without notice of equities. There is nothing in the fact of a pledge of certificates, indorsed in blank, to put a bona fide pledgee upon inquiry as to who is the real owner. The presumption is, that the holder is the owner, and has given value for the same.[4] And the pledgee, receiving such choses in action so as to be vested with the legal title and ownership, also enjoys the benefit of the presumption that the assignment was executed to him upon a sufficient and valuable consideration, and that he is a holder for value, with a good title.[5]

[1] Heritage *v.* Hedges, 72 Ind. 247.
[2] Brewster *v.* Galloway, 4 Lea, 558.
[3] Wickham *v.* Morehouse, 16 Fed. Rep. 324.
[4] Stone *v.* Brown, 54 Tex. 330.
[5] Tallman *v.* Hoey, 89 N. Y. 537; Belden *v.* Meeker, 47 Ib. 311.

CHAPTER XLV.

ESTOPPEL IN PAIS, IN FAVOR OF PLEDGEES.

§432. Estoppel in pais, as applied to non-negotiable collateral.
433. Essential elements of estoppel under such collateral.
434. Recognized propositions of an estoppel in pais.
435. Estoppel, by representations upon non-negotiable securities.
436. Estoppel of owner, in cases of tortious pledge.
437. The innocent pledgee for value protected as against owner.
438. Rights of pledgee under blank indorsements.
439. Moore *v.* Metropolitan National Bank.
440. Estoppel of corporations as against innocent pledgees for value.

§ 432. ESTOPPEL IN PAIS, AS APPLIED TO NON-NEGOTIABLE COLLATERAL.—No distinction can be drawn between the equitable title of a pledgee for value of a non-negotiable chose in action, where the rules of estoppel in pais are invoked, and the legal title of the pledgee for value holding negotiable collateral securities, under indorsement and delivery.[1] The representations made in non-negotiable choses in action are enforced, under the rules of equitable estoppel, to the same extent as the like representations contained in instruments negotiable by the commercial law. They are subject to the like qualification, when sought to be enforced by a pledgee for value, that faith and credit have been given to such collateral securities upon the belief that the representations made on its face and by indorsement, are true.[2] Equities existing between the original parties to the contract

[1] Moore *v.* Metropolitan Nat. Bank, 55 N. Y. 41.

[2] Armour *v.* Michigan Central R. R. Co. 65 N. Y. 111, 123; Moore *v.* Metropolitan Nat. Bank, 55 Ib. 41; Goodwin *v.* Robarts, L. R. 10 Ex. 76, 337; 1 App. 476, 489.

yield to the rules of estoppel in pais, in cases where it appears from the terms of the collateral security or by indorsement that the intention of the person executing the same must have been that such chose in action should be assignable free from and unaffected by all equities, defenses, or set-offs of such maker or obligor.[1] The equities and defenses to which a non-negotiable chose in action is *per se* subject, are not affected by the application of the rules of estoppel in pais in favor of bona fide pledgees for value, and receiving an assignment, as against the real owner.[2]

The rule that where a person gives a non-negotiable security to another for the very purpose of raising money upon it, he is estopped to set up any collateral contract to defeat the title of an innocent person advancing money on the faith of the statements in the bond, was approved by the Court of Queen's Bench, in a case where a secret agreement was made by a corporation with the person to whom a bond was issued, that he should pay the same, and the accruing interest, and indemnify the corporation. Such contract constituted no defense as against innocent holders for value as the person in possession of the bond was able by means of the defendant's acts, to deceive the parties who advanced money on the faith of the statements contained in the bond.[3] And where, upon an absolute failure of consideration by a person to whom a bond had been issued, an application of the rules of equitable estoppel in favor of a holder for value, without notice, was refused, the title acquired to a mere chose in action being subject to all the equities between the original parties to the contract, the court (Lush, J.) said: "But if the bond had been given for the purpose of raising money on it, it would have made all the difference."[4]

[1] In re Agra *v.* Masterman's Bank, L. R. 2 Ch. 391, 397.

[2] Trustees of Union College *v.* Wheeler, 61 N. Y. 114.

[3] Dickson *v.* Swansea R. R. Co. L. R. 6 Q. B. 44.

[4] In re Natal Investment Co. L. R. 3 Ch. 355.

§ 433. Essential elements of Estoppel, under such Collateral.—The essential elements of equitable estoppel are: a representation or concealment of material facts; such representation must be made with knowledge, unless the party making the representation is bound to know the facts, or ignorance is the result of gross neglect; the party to whom it is made must be ignorant of the truth of the matter; it must be made with the intention that the other shall act upon it, and a culpable neglect on the part of the person sought to be estopped, the effect of which is to make a fraud on the party setting up the estoppel, will supply the place of intent; the other party must have been induced to act upon the representations.[1] The rules of equitable estoppel are founded, to a great extent, upon the existence of fraud in the transaction, alike in its purposes and in its results.[2] To constitute an estoppel, both an opportunity and an apparent duty to speak must concur with knowledge that reliance is being placed upon the written representations of the person sought to be estopped, and in cases of loan, that the lender of money is acting or about to act as he would not do if the truth was declared.[3] And silence merely of the obligor of a non-negotiable chose in action, during the course of negotiation, where the assignment is made with his consent, is sufficient to entitle an innocent pledgee deceived thereby to the benefit of an application of the rules of equitable estoppel as against any attempt of the obligor to set up defenses or equities to defeat his title, or its enforcement.[4] But no estoppel arises where the representation consists in an incorrect statement of law, nor upon false

[1] Griffin *v.* Dwight, 6 Col. 584; Patterson *v.* Hitchcock, 3 Col. 536.

[2] Traun *v* Kiefer, 31 Ala. 136; Martin *v.* Zellerbach, 38 Cal. 318; Taylor *v.* Ely, 25 Conn. 250; Davidson *v.* Young, 38 Ill. 146; People *v.* Brown, 67 Ill. 437; Powell *v.* Rogers, 105 Ib. 318; Dixfield *v.* Newton, 41 Me. 221; Grimes *v.* Kimball, 8 Allen, 153; Odlin *v.* Gove, 41 N. H. 465; Wegh *v.* Boylan, 85 N. Y. 394; Hill *v.* Epley, 31 Pa. St. 331; Eldred *v.* Hazlett, 33 Ib. 307; White *v.* Langdon, 30 Vt. 599.

[3] Vicle *v.* Judson, 82 N. Y. 33.

[4] Wegh *v.* Boylan, 85 N. Y. 394; Watson *v.* McLaren, 19 Wend. 563.

statements made to conceal an illegal contract.[1] And the document upon which advances are made, must be an indicia of title or a symbol of property, by the transfer of which the legal title and right to possession of the property or funds represented, may pass to the lender of money.[2]

§ 434. Recognized propositions of an Estoppel in pais.—In a case in which it was sought to estop a common carrier from denying that it was in possession of certain property, which it was, if in possession, bound to deliver, the representations to the person advancing money being contained in non-negotiable "advice notes," the Court of Common Pleas (Brett, J.) announced certain recognized propositions of an estoppel in pais, within the lines of which it was necessary such innocent person should bring his claim: "If a man by his words or conduct wilfully endeavors to cause another to believe in a certain state of things which the first knows to be false, and if the second believes in such state of things, and acts upon his belief; he who knowingly made the false statement is estopped from averring afterwards that such a state of things did not exist."[3] Another recognized proposition seems to be that, "If a man, either in express terms or by conduct, makes a representation to another of the existence of a certain state of facts which he intends to be acted upon in a certain way, and it be acted upon in that way, in the belief of the existence of such a state of facts, to the damage of him who so believes and acts, the first is estopped from denying the ex-

[1] Rashdall *v.* Ford, L. R. 2 Eq. 750. In Horton *v.* Westminster Comm. 7 Ex. 780, 791, Martin, B. says: "The meaning of estoppel is this—that the parties agree, for the purpose of a particular transaction, to state certain facts as true, and that, so far as regards that transaction, there shall be no question about them. But the whole matter is opened where the statement is made for the purpose of concealing an illegal contract; for persons cannot be allowed to escape from the law by making a false statement."

[2] Imperial Bank *v.* London Dock Co. L. R. 5 Ch. D. 195; Gunn *v.* Bolckow, L. R. 10 Ch. 499.

[3] Carr *v.* London Ry. Co. L. R. 10 C. P. 307, 316.

istence of such a state of facts.[1] And "if a man, whatever his real meaning may be, so conducts himself that a reasonable man would take his conduct to mean a certain representation of facts, and that it was a true representation, and that the latter was intended to act upon it in a particular way, and he with such belief does act in that way to his damage, the first is estopped from denying that the facts were as represented."

Another rule of estoppel is, that "If in the transaction itself which is in dispute, one has led another into the belief of a certain state of facts by conduct of culpable negligence calculated to have that result, and such culpable negligence has been the proximate cause of leading and has led the other to act by mistake upon such belief, to his prejudice, the second cannot be heard afterwards, as against the first, to show that the state of facts referred to did not exist.[2]

Another rule of estoppel, and its limitation, founded upon a representation made by a vendor to a person advancing money for property to the vendee, whose fraud must cause loss to one or the other of two persons, was stated: that where one states a thing to another, with a view to the other altering his position, or knowing that, as a reasonable man, he will alter his position, then the person to whom the statement is made is entitled to hold the other bound, and the matter is regulated by the state of facts imported by the statement.[3] But the reason of the rule ceases at once when a stranger to the arrangement seeks to avail himself of the statements which were not made as a basis for him to act upon. They are for a stranger evidence against the party making the statement, but no more than evidence which may be rebutted; between the parties they form an estoppel at law.[4]

[1] Carr *v.* London Ry. Co. L. R. 10 C. P. 317. (Brett, J.).

[2] Ibid, p. 318.

[3] Knights *v.* Wiffin, L. R. 5 Q. B. 660 (Blackburn, J.).

[4] Wegh *v.* Boylan, 85 N. Y. 398; Knights *v.* Wiffin, L. R. 5 Q. B. 660. (Mellor, J.), citing Blackburn Sales, 162.

§ 435. Estoppel, by representations upon non-Negotiable Collateral.—A bona fide pledgee for value, without notice of fraud or other equities, is protected, under approved rules of estoppel in pais, where the obligor upon the non-negotiable chose in action has declared upon its face, or by indorsement, that he has no defenses, equities, or set-offs to the debt or duty secured, or that the consideration has been paid in full, or other like representations.[1] Such declarations of "no defenses, equities or set-offs," made by the debtor in writing and generally under seal, forms muniments of title, and are conclusive, under estoppel, when such choses in action are in the possession of bona fide pledgees, for value advanced on the credit of such representations, without notice of fraud.[2] Nor is the benefit of such declarations confined to the first holder for value. A sub-pledgee of such non-negotiable collaterals, advancing value in good faith, without notice, takes a good title as against the obligor, who is estopped to set up any defense in opposition to his own declarations made to be acted upon by successive assignees of the non-negotiable security.[3]

§ 436. Estoppel of Owner, in cases of tortious Pledge.—The rules of estoppel in pais are enforced against an owner of a non-negotiable chose in action, who has, with mistaken confidence, entrusted the indicia of title and the apparent absolute ownership, by indorsement and delivery to a third person, so that he is able to deceive bona fide pledgees, advancing value upon the faith and credit of such documents of title and apparent absolute ownership, without notice that the act of pledge is a fraudulent misappropriation and an unauthorized act.[4] The only limitation

[1] Smyth *v.* Munroe, 84 N. Y. 354; Payne *v.* Burnham, 62 Ib. 69.

[2] Wegh *v.* Boylan, 85 N. Y. 394; Ryall *v.* Rowles, W. & T. Lead Cas. 2, pt. 2, 1673.

[3] Ashton's App. 73 Pa. St. 153.

[4] Combes *v.* Chandler, 33 Ohio St. 178; Moore *v.* Bank, 55 N. Y. 41; McNeil *v.* Tenth Nat. Bank, 46 Ib. 325; Horn *v.* Cole, 51 N. H. 287;

upon the application of estoppel upon this ground is, that it must be the affirmative act of the owner himself in conferring such ownership that has enabled the deceit to be practiced upon the innocent pledgee.[1] The payee of a non-negotiable certificate of deposit who has indorsed the same in blank and entrusted it to another person, will have no defense as against an innocent pledgee receiving the same from such fraudulent person for an advance, without notice. The pledgee will hold the collateral security free from equities existing between the pledgor and the payee. The apparent ownership and legal right to the collateral being vested in the pledgor, the pledgee may, in good faith, safely loan his money to him.[2] The rule is applied where the owner of a deposit in a bank indorses his letter of credit in blank, and hands the same to a third person who misappropriates it.[3] A cestui que trust is not allowed to impeach the title of a pledgee for value, of a non-negotiable chose in action, part of the trust estate, where the trustee is clothed with full power in its management, and the security is received in good faith, and without notice.[4] The title of an innocent holder for value cannot be defeated by the owner, who has conferred such title and apparent ownership on the person by whom the securities have been assigned, upon any claim of infirmity in the title thus conferred, or the invalidity of the collateral security.[5]

§ 437. THE INNOCENT PLEDGEE FOR VALUE PROTECTED, AS AGAINST OWNER.—The real owner of goods who suffers another to have possession of his property, or of those docu-

Cowdrey *v.* Vanderburgh, 101 U. S. 572; Merchants' Bank *v.* Phœnix, etc. Co. L. R. 5 Ch. D. 217 (Jessell, M. R.); Briggs *v.* Jones, L. R. 10 Eq. 92; Herrick *v.* Attwood, 25 Beav. 205; 2 DeG. & J. 21; Vickers *v.* Hertz, L. R. 2 Sc. App. 113; Goodwin *v.* Robarts, L. R. 10 Ex. 76, 337; 1 App. 476.

[1] Davis *v.* Beckstein, 69 N. Y. 442.

[2] International Bank *v.* German Bank, 71 Mo. 183.

[3] Weirick *v.* Mahoning Co. Bank, 16 Ohio St. 296.

[4] Dillaye *v.* Commercial Bank, 51 N. Y. 345.

[5] Clark *v.* Roberts, 25 Hun, 86.

ments which are the evidence of property, is bound by a sale or pledge which he has enabled the other person to make. So long as the document of title remains in the possession of the person who fraudulently obtained it, the vendor, who has been cheated out of its possession, may reclaim and recover it; but at the moment such document of title passes into the hands of a holder for value, a pledgee, to whom it is indorsed for a valuable advance, made in good faith, without notice, the right of the vendor to follow it is at an end. This rule was applied by the Privy Council of England, where a document of title of property, obtained by a vendee by fraud, was at once indorsed for a valuable consideration, without notice. The fraudulent person became bankrupt, and the owners lost their property by reason of the transfer to a pledgee who received the same bona fide, for a valuable consideration, and in ignorance of the fraud.[1] "The possession was not only united to the previous ownership with the consent (however obtained) of the person temporarily entitled to it, but transferred for the express purpose of giving to the owner [the pledgee] an absolute dominion over his own property," and the principle was announced that an ownership at the time perfect at law, though voidable as to part, viz., the possession, cannot in principle be treated differently from an ownership voidable as to the whole, but in the interim protected by the interposition of a bona fide purchaser, for a valuable consideration (applied in the principal case to a bona fide pledgee, for a valuable consideration).

The rule of estoppel by conduct is applied in cases where a vendee obtains possession of a chattel, with the intention, by the vendor, to transfer both the property and possession, although the vendee has committed a false and fraudulent misrepresentation in order to effect the contract or obtain the possession. The property vests in the vendee until the vendor has done some act to disaffirm the transac-

[1] The Marie Joseph, L. R. 1 Pr. C. 219. (Lord Chelmsford, Lord Chan.)

tion, and the legal consequence is, that if before the disaffirmance the fraudulent vendee has transferred the whole or a partial interest in the chattel to an innocent transferee, the title of such transferee is good against the vendor.[1] The doctrine of estoppel by conduct was enforced where a bill of exchange, the drawing and indorsements of which were forgeries, having been accepted for honor, were discounted by a bank. Upon discovery of the forgery, the bank sued the acceptor, and it was held, by the Court of Common Pleas, that as the acceptor had induced the bank to part with its money upon the faith of his authentication of the bill, he was estopped to dispute its genuineness.[2] But the payment of a bill of exchange, the name of the acceptor being forged, by such acceptor, raises no estoppel as against him upon the forgery of his name as acceptor upon another bill, held by the same person.[3]

§ 438. ESTOPPEL, UNDER INDORSEMENT OF CHOSES IN ACTION.—The principle of estoppel by conduct that, when the owner of property in any form clothes another with the apparent title and power of disposition, third parties who are thereby induced to deal with him, are protected, is applied to choses in action, non-negotiable in character.[4] The delivery of choses in action indorsed in blank as collateral security for value, transfers the property to the pledgee, and authorizes him to write over the signature a formal and regular assignment, if it should become necessary, or if the pledgee should think it is for his interest so to do. An indorsement in blank of such non-negotiable securities is sufficient where they are payable, under statutory enactments, to the person to whom issued, his representatives or assigns, the same appearing upon the face of the certificates, and

[1] Kingsford *v.* Merry, 11 Ex. 577. (Pollock, C. B), a case of pledge; Dyer *v.* Pearson, 3 B. & C. 42.

[2] Phillips *v.* Im Thorn, L. R. 1 C. P. 463.

[3] Morris *v.* Bethell, L. R. 5 C. P. 47.

[4] Cowdrey *v.* Vandenbergh, 101 U. S. 572, 575; McNeil *v.* Tenth Nat. Bank, 46 N. Y. 325.

are an appropriation of some distinctive fund. A pledgee loaning money in good faith to a person holding such certificates indorsed in blank comes within the rule of estoppel stated, no knowledge or notice being chargeable against him by reason of his dealing with an apparent owner of non-negotiable securities under blank indorsement. No suspicion arises that the pledgee acquired them unfairly; on the contrary, the possession of such certificates by the pledgor indorsed in blank is prima facie evidence of ownership. In cases of non-negotiable certificates, where transfer by indorsement in blank is ordinarily used, and appears in the hand-writing of the original holder, the pledgee is entitled to the benefit of the legal presumption in favor of his right which always arises from possession, until the contrary appears.[1] In other cases, where the non-negotiable chose in action, the subject of pledge, is merely a statement of the auditing and allowing of an account for work done, by a municipal officer, but with no promise to pay any sum of money, nor an order upon any person or fund for the payment of money, and no element of estoppel arises to control the relations of the parties, pledgees, or parties claiming under them by purchase, can take such interest only as was originally pledged by the owner. Any holder of such a certificate is subject to the equities of the real owner, whether chargeable with notice or not, so long as the same remains indorsed in blank. Should, however, the power to fill up such blank with an absolute assignment be exercised by the pledgee, the presumption from the delivery of a chose in action indorsed in blank as collateral security being prima facie an authorization to the pledgee so to do, and the same is transferred to an innocent holder for value, by a like absolute assignment, the owner may be estopped in the case of any chose in action.[2] The pledgor in the

[1] Baldwin *v.* Ely, 9 How. 580.

[2] Cowdrey *v.* Vandenbergh, 101 U. S. 572, 576. The United States Supreme Court (Field, Jus.), referring to McNeil *v.* Tenth Nat. Bank, 46 N. Y. 325, say: "The rights of innocent third parties, as the court there observes, 'do not depend upon the

case of Moore *v.* Metroplitan National Bank,[1] received the non-negotiable certificate from the owner indorsed with an absolute assignment, and upon his fraudulent deposit of the certificate as collateral security with the bank, an absolute assignment to the pledgee was in turn executed by him.

§ 439. Moore *v.* Metropolitan National Bank.—A leading case on the law of estoppel in pais, as applied to

actual title or authority of the party with whom they deal directly, but are derived from the act of the real owner, which precludes him from disputing, as against them, the existence of the title or power which, through negligence or mistaken confidence, he caused or allowed to appear to be vested in the party making the conveyance.' Here the complainants could have expressed in their indorsement the purpose of the deposit of the certificate with Blumenburgh,—that it was as security for a specified sum of money,—and thus imparted notice to all subsequent purchasers or assignees that the pledgee held only a qualified interest in the claim. But having indorsed their name in blank, they virtually authorized the holder to transfer or dispose of the certificate by writing an absolute assignment over their signature. Had it, therefore, appeared in this case that Cowdrey paid any money for the certificate, and took it with the assignment which he himself afterwards wrote over the signature of the complainants, we are inclined to think that his defense would have been sustainable. But as he has not shown that he parted with any value for the claim, and no assignment was at the time indorsed over the blank signature, he must be treated as standing in the shoes of his alleged vendor, Blumenburgh."

[1] 55 N. Y. 41. Moore was the owner of a certificate of indebtedness of the State of New York for $10,000, which he was induced to deliver to one Miller with the indorsement thereon, "$10,000. For value received, I hereby transfer and set over to Isaac Miller the within described amount, say $10,000. Levi Moore." The assignment was obtained by false representations of Miller, and upon an agreement to return the certificate if not sold within three weeks. After the expiration of the time agreed upon, Miller, by a similar indorsement, assigned the certificate to the Metropolitan National Bank as collateral security for his promissory note, which the bank discounted. An equitable suit was brought by Moore to restrain the bank from disposing of and to recover possession of the certificate. The suit was dismissed, the claim of the bank being supported as a bona fide pledgee for value. The case is cited and approved in Driscoll *v.* West Bradley Co. 59 N. Y. 96, 101; Armour *v.* Michigan Central R. R. Co. 65 Ib. 111, 123; Wegh *v.* Boylan, 85 Ib. 394, 401; and explained in Trustees *v.* Wheeler, 61 Ib. 114.

non-negotiable collateral securities, Moore *v.* Metropolitan National Bank[1] arose from the misappropriation as collateral security of a non-negotiable chose in action by one who was entrusted with the title and apparent ownership. The court (Grover, J.) stated the argument: "The reasons are that such purchase was made upon the faith of the title which the owner had apparently given, and that it would be contrary to justice and good conscience to permit him to assert his real title against an innocent purchaser from one clothed by him with all the indicia of ownership and power of disposition. Another reason was, that were the rule otherwise, it would afford opportunities for the perpetration of frauds upon the purchasers from such apparent owners. Where one, known to be the owner of shares or chattels, delivers to another the scrip or possession of the chattels, together with an absolute written transfer of all his title thereto, he thereby enables him to hold himself out as owner, and, as such, obtain credit upon and make sales of the property; and if, after he had so done, the owner was permitted to come in and assert his title against those dealing upon the faith of these appearances, the dishonest might combine and practice the grossest frauds. Another reason is, that it presents a proper case for the application of the legal maxim that, where one of two innocent parties must sustain a loss from the fraud of a third, such loss should fall upon the one, if either, whose act has enabled such fraud to be committed. All these reasons, it is obvious, apply with all their force to choses in action."

It was claimed that a different rule should be applied to the merely equitable title acquired by the assignee of a chose in action than to the legal title obtained upon a transfer of shares of stock or chattels, but the court said:[2] "Upon what ground the same state of facts that will estop a party from the assertion of a legal title will not also estop him from the assertion of an equitable one the counsel fails

[1] 55 N. Y. 48.

[2] 55 N. Y. 48.

to show, for the very good reason that no such ground exists. It is so obvious that the estoppel should, upon principle, apply to the latter equally with the former, that a distinction can only be justified upon authority."

§ 440. Estoppel of Corporations, as against innocent Holders for value. — Equitable estoppel arose against a corporation which issued non-negotiable choses in action purporting to be issued pursuant to powers conferred by statute, although the issue was illegal and in violation of statutory powers, when in the hands of an innocent holder for value. As said by Mellor, Judge of the Court of Queen's Bench,[1] "I wish to rest my judgment on the general doctrine of estoppel. * * * The holder may, by a writing under his hand, transfer the mortgages to any person, and the Act gives the form of indorsement by which the transfer may be made. There is a provision for registering the transfer, and when that is completed any person who is an innocent holder has a complete title. The commissioners, who have borrowed the money and enabled the transfer of the mortgage, cannot afterwards deny their liability on the ground that the mortgage was given, not for money lent, but for some purpose which they allege to be illegal." The Chief Justice (Cockburn):[2] "The commissioners might be wrong in allowing these debentures to go forth, knowing that they might come into the hands of an innocent holder for value, but they are estopped from alleging that the debentures were illegally issued." And Blackburn (J.):[3] "I hold that the commissioners, who have stated on the face of the mortgages that money had been advanced and lent on the credit and for the purposes of the commissioners, are precluded as against bona fide transferees from denying the truth of that statement."

[1] Webb *v.* Herne Bay Comm. L. R. 5 Q. B. 642, 655; In re Bahia & S. F. Ry. Co. L. R. 3 Q B. 583; Freeman *v.* Cooke, 2 Ex. 654.

[2] Webb *v.* Herne Bay Comm. supra, p. 651; Pickard *v.* Sears, 6 A. & E. 469.

[3] Webb *v.* Herne Bay Comm. supra, p. 653, 654.

CHAPTER XLVI.

THE PLEDGEE'S RIGHTS AND DUTIES.

§441. The pledgee's application of non-negotiable collateral.
442. The pledgee's duty as to collection.
443. The pledgee's sale of non-negotiable collateral.
444. The pledgor's rights upon wrongful sale or sub-pledge.
445. Talty *v.* Freedman's Saving and Trust Company.
446. The pledgee's remedies, at law and in equity.
447. The pledgee's recovery on choses in action.
448. Payment and discharge of pledgor.

§ 441. THE PLEDGEE'S APPLICATION OF NON-NEGOTIABLE COLLATERAL.—The pledgee of non-negotiable choses in action is not any more entitled than any other holder of collateral securities to retain a surplus arising from a sale or collection, after satisfaction of the debt, upon a claim to apply such surplus to some account other the principal debt secured. Life insurance policies were transferred, by indorsement and delivery, as collateral security for a certain indebtedness. The pledgor having deceased, the pledgee sold the insurance policies, realizing more than enough to pay the particular debt, and then sought to apply the surplus in payment of simple contract debts, to the injury of specialty creditors. The pledgee also claimed a general lien as executor. The surplus remaining was required to be paid over for the benefit of the specialty creditors.[1] Generally, clear evidence is required of an express agreement or

[1] Talbott *v.* Frere, L. R. 9 Ch. D. 568; overruling Spalding *v.* Thompson, 26 Beav. 367; In re Haselpot's Est. L.R. 13 Eq. 327; ex parte Bank, L. R. 14 Eq. 507, in which an executor's lien, under such circumstances, attached even to unsecured debts.

understanding by the parties to the contract of pledge that the pledgee may apply the money realized upon a pledge of insurance policies, a loss having occurred, to any other debt or liability than that for which they were specifically pledged, in order to entitle the pledgee to make such application.[1] The rule applies to transactions with brokers, upon deposit of securities for the benefit of holders of notes entrusted to such brokers for sale. In the absence of agreement, the equity thus created is preferred as against the claim of brokers seeking to appropriate the proceeds of such securities to personal loans to customers for which no collateral security was deposited. Notwithstanding the customers may have become insolvent, the equitable rule which, on proper occasions, extends securities to other debts, is not applied to such transactions.[2]

Parties to the contract of pledge may extend the benefit of collateral securities held by the pledgee to other debts and obligations of the pledgor other than those originally secured. An agreement that insurance policies, pledged for a specific debt, should be applied to cover "any and all pecuniary obligations" of the pledgor, entitled the pledgee to apply the proceeds of the collateral securities in payment of the whole debt due.[3] And the same rule as to the disposition of the surplus resulting from the realization of collateral securities was applied in favor of a third person, where policies of insurance had been pledged, and then sub-pledged, and the pledgee directed the sub-pledgee to hold such surplus for the benefit of such third person, making advances thereon, of which assignment notice was also given by the beneficiary.[4]

§ 442. THE PLEDGEE'S DUTY AS TO COLLECTION.—The pledgee of non-negotiable choses in action is required to

[1] Bulkley *v.* Garrett, 60 Pa. St. 333.
[2] James' App. 89 Pa. St. 54.
[3] Boardman *v.* Holmes, 124 Mass. 438.
[4] Myers *v.* United Guaranty Co. 7 DeG. M. & G. 112.

exercise reasonable care and diligence in their collection.[1] Upon as assignment of a lease as collateral security for a note, the pledgee should collect the rents. Such collections are applied upon the note, at maturity.[2] The failure of a pledgee to collect non-negotiable collateral securities, or to enforce agreements made by third persons assigned to them, so that the collaterals are eventually lost through the subsequent insolvency of the parties, is not, in the absence of gross negligence or fraud, such a default as to render a pledgee liable for the consequent injury to the pledgor.[3] The pledgee of a part interest in a note, is under no obligation to pursue its collection; and if lost, is not chargeable with the full amount, or any part of the note.[4] Upon a discount of commercial paper, a judgment against a third party was assigned as collateral security, with power of sale upon default. At the time of the pledge, the judgment debtor could have satisfied the judgment, but when enforced at the request of the pledgor, his property had been exhausted by previous levies. Evidence not being admissible to change the written contract of pledge, the pledgee was not required to collect the judgment until maturity of the principal debt and default, and the pledgor, who remained the general owner of the collateral security, should have enforced its collection himself.[5] The pledgee, however, is answerable for the face value of non-negotiable collateral securities where they are lost by reason of his inexcusable default, although such loss is not presumed from mere non-collection.[6]

§ 443. THE PLEDGEE'S SALE OF NON-NEGOTIABLE COLLATERAL.—In the absence of any special contract giving a

[1] Whittaker *v.* Charleston Gas. Co. 16 W. Va. 717.

[2] Dewey *v.* Bowman, 8 Cal. 145.

[3] Runals *v.* Harding, 83 Ill. 75.

[4] Smouse *v.* Bail, 1 Grant's Cas. 397.

[5] Bast *v.* Bank, 101 U. S. 93.

[6] Word *v.* Morgan, 5 Sneed, 79; Wellsburg Bank *v.* Kimberlands, 16 W. Va. 555; Williams *v.* Price, 1 Sim. & S. 581; Reeves *v.* Plough, 41 Ind. 204; Burrows *v.* Bangs, 34 Mich. 304.

power of sale of choses in action held as collateral security, the pledgee is not entitled to sell such collaterals, except after due demand of the principal debt, and default, and reasonable notice of the time and place of sale.[1] Nor will a court of equity decree a sale of non-negotiable collateral securities, in aid of a pledgee for value, where there is no right to sell such securities, and no contract authorizing a sale.[2] Where a power of sale of such collaterals, either public or private, upon default, without notice to the pledgor, is given in a contract of pledge, it is optional with the pledgee whether he will at once proceed to sell upon default. Any extension of time or delay in making sale, is a benefit to the pledgor, as it increases his opportunity to redeem his collateral securities.[3]

§ 444. The Pledgor's rights upon wrongful Sale or sub-Pledge.—The right of the pledgor to recover his non-negotiable choses in action where the pledgee has assumed, before maturity of the principal note, to sub-pledge or sell the same, is subject to the equitable limitation that he must first have tendered or paid the loan to secure the payment of which the collateral was deposited. The act of the pledgee, in either case, is not such a destruction of his special interest in such collateral, as to destroy the contract of pledge, and entitle the pledgor to demand return of the collateral from the sub-pledgee or purchaser, without a tender or payment of his debt.[4] This equitable rule was enforced in the United States Supreme Court, in Talty *v.* Freedman's Savings and Trust Company,[5] where the collateral security was a non-negotiable certificate for work and materials issued by the commissioners of audit of the

[1] Dewey *v.* Bowman, 8 Cal. 145; Robinson *v.* Hurley, 11 Iowa 410.

[2] Whittaker *v.* Charleston Gas. Co. 16 W. Va. 717.

[3] Robinson *v.* Hurley, 11 Iowa, 410.

[4] Talty *v.* Freedman's Savings and Trust Co. 93 U. S. 321; Johnson *v.* Stear, 15 C. B. N. S. 330; Donald *v.* Suckling, L. R. 1 Q. B. 585; Halliday *v.* Holgate L. R. 3 Eq. 299.

[5] 93 U. S. 321.

city of Washington, indorsed in blank; and by the Court of Queen's Bench of England, in Donald *v.* Suckling,[1] a case arising from a sub-pledgee of debentures, non-negotiable. The debentures were deposited by A with B as collateral for a bill of exchange indorsed by A and discounted by B, with power of sale upon default. B, before maturity of the bill, sub-pledged the debentures to C for a larger sum than the amount of the bill. The bill being dishonored and unpaid, A, without tender or payment of the debt to either the pledgee or sub-pledgee, brought detinue against C. The action was dismissed.[2]

§ 445. Talty v. Freedman's Savings & Trust Co. —In this leading case, involving the rights of a purchaser under a sale of a chose in action held by a pledgee and sold before maturity of the principal debt,[3] the United States Supreme Court (Matthews, Jus.) says: "Kendig was not a factor with a mere lien. He was a pledgee. The collateral was placed in his hands to secure the payment of the note. It was admitted by Talty [the pledgor] that Kendig was

[1] L. R. 1 Q. B. 585.

[2] L. R. 1 Q. B. 585 Opinions were given by four judges, Cockburn, C. J., Blackburn and Mellor, JJ., in favor of the sub-pledgee; Shee, J., dissenting. Extracts from the opinions are given in Chap. IX., §82, p. 111, *n.*

[3] 93 U. S. 321. Talty had a claim against the city of Washington for work and materials, amounting to $6,096.75, for the payment of which he received a certificate from the commissioners. Two days afterwards, he employed Kendig, a broker, to negotiate a loan, giving him his sixty-day note of $3,000, payable to his own order, and indorsed in blank, and the certificate, also indorsed in blank, to be used as collateral. The note was sold the same day, and the proceeds paid to Talty; and a short time afterwards Kendig sold the collateral to the Trust Company, a bona fide purchaser, and with the proceeds took up the note. An offer to pay the principal note and demand for the collateral was made by Talty a few days before maturity, and learning of the sale, after making a demand, he obtained the certificate from the purchaser by replevin. No tender or payment was made by Talty, either to the purchaser or the pledgee. The only disputed fact was as to the time at which the power of sale was to arise: Kendig claiming at once; Talty, upon default, at maturity.

authorized to sell it if the note were not paid at maturity. Kendig had a special property in the collateral. He was a pawnee for the purposes of the pledge. * * A tender to the second pledgee of the amount due from the first pledgor to the first pledgee extinguishes *ipso facto* the title of the second pledgee; but that there can be no recovery without tender of payment is equally well settled. But it is suggested that the note was in the hands of Kendig, and that therefore Talty could not safely pay the amount due upon it to the holder of the collateral. The like fact existed in Donald *v.* Suckling. It is not adverted to in the arguments of counsel, nor in the opinions of the judges in that case. It could not, therefore, have been regarded by either as of any significance. The answer here to the objection is obvious. The note, a few days before its maturity, was in the hands of Kendig. There being no proof to the contrary, it is presumed to have remained there. This suit was commenced after it matured. Talty might then have paid the amount due upon it to the defendant in error [the purchaser from the pledgee] and could thereupon have defended successfully in a suit on the note, whether brought by Kendig or any indorsee taking it after due."

§ 446. THE PLEDGEE'S REMEDIES, AT LAW AND IN EQUITY.—Equity will take jurisdiction where there are different interests as between the owner of non-negotiable collateral securities, the first assignee, and the subsequent pledgee, thus disposing of the whole litigation in one suit.[1] And where necessary, will decree a foreclosure and order a sale of such collaterals, upon a bill filed by the pledgee.[2] A pledgee will be aided in equity, in rendering his security available, as where a policy of insurance was pledged as collateral security for a debt and the pledgor died, leaving his estate insolvent, and most of the personal representatives disclaimed, and no administration was taken out, and the

[1] Thayer *v.* Daniels, 113 Mass. 129. [2] Robinson *v.* Hurley, 11 Iowa, 410.

amount of the principal debt was three times that of the money covered by the insurance policy. The company refused to pay the pledgee the insurance money because of the failure to appoint a representative of the estate. A court of chancery dispensed with the presence of the legal representatives, and ordered the insurance company to pay the money to the pledgee.[1] Otherwise, however, where the amount coming upon the policy is much larger than the debt, although the estate be insolvent.[2] An insurance company cannot defeat the rights of a pledgee of insurance policies to relief by insisting that no assignment can be made, without the written consent of the company, as such prohibition has no application to a deposit as collateral security.[3] A bill in equity to redeem a certificate of membership of the New York Cotton Exchange, transferable by assignment under certain restrictions, which had been pledged as collateral security for a promissory note, was bought by a receiver appointed for the bankrupt pledgor, after a tender of the debt and demand for the collateral securities. Redemption was allowed upon the equitable terms of payment of the principal debt.[4] The equitable character of an interest in a chose in action, or in a fund, possessed by the holder, is not of itself, sufficient to entitle him to proceed in equity. Nor will the aid of equity be given to recover moneys alleged to be due under collateral contracts, as a complete remedy may be had at law.[5] Nor where there is no right to sell non-negotiable collateral securities, and no contract authorizing such sale, will the aid of a court of chancery be given to a pledgee praying that a sale may be ordered.[6] Equity, however, where a party seeks to ob-

[1] Curtius *v.* Caledonian Ins. Co., L. R. 19 Ch. D. 534; a like case, Crossley *v.* Glasgow Ins. Co., L. R. 4 Ib. 421.

[2] Webster *v.* British Empire Ins. Co., L. R. 15 Ch. D. 169.

[3] Ellis *v.* Kreutzinger, 27 Mo. 311.

[4] In re Werder, 15 Fed. Rep. 789; Powell *v.* Waldron, 89 N. Y. 328; Hyde *v.* Woods, 94 U. S. 523.

[5] N.Y. Guaranty, etc., Co. *v.* Water Co. 107 U. S. 205.

[6] Whittaker *v.* Charleston Gas Co. 16 W. Va. 717.

tain the benefit of a judgment obtained upon a debt assigned as collateral security, will not require prior resort to other securities where it does not appear they are of greater value than the excess of the debt secured over the amount of the assigned debt and judgment.[1]

Courts of law enforce the rights of pledgees of choses in action, and equitable assignments of funds. Generally, the real party in interest may, under statutory or code enactments, bring an action in his own name, against the parties bound upon such collateral securities, or holding funds subject to assignment.[2] An assignment of warrants or orders, drawn by one municipal officer upon another, where countersigned and registered by the treasurer, vests the legal title in the assignee, and thus enables him to sue in his own name.[3] Where an assignor of a non-negotiable chose in action collusively dismissed a suit brought in his name by the assignee, upon learning of which, the assignee brought another suit, a court of law refused to hold the second suit barred by the dismissal of the first.[4] The receipt of an insurance policy upon the life of a debtor as collateral security for the payment of a debt, is not of itself sufficient to constitute a defense to an action of debt by the creditor upon the bond representing the personal indebtedness.[5]

§ 447.—The Pledgee's recovery on choses in action.—The pledgee holding choses in action as collateral security for a loan or other valuable consideration, is entitled to collect such securities, as they mature or become payable, and to hold the proceeds to be applied, at maturity, to the payment of the debt. The pledgee is entitled to en-

[1] Batesville Inst. *v.* Kauffman, 18 Wall. 151.

[2] Brice *v.* Bannister, L. R. 3 Q. B. Div. 569; Field *v.* Megaw, L. R. 4 Ib. 660; Brown *v.* Bateman, 6 Ib. 272; Whittaker *v.* Charleston Gas Co. 16 W. Va. 717; Welch *v.* Mandeville, 1 Wheat. 236.

[3] People *v.* Johnson, 100 Ill. 537; Creighton *v.* Hyde Park, 6 Bradw. 274.

[4] Welch *v.* Mandeville, 1 Wheat. 236.

[5] Reeves *v.* Plough, 41 Ind. 204; Burrows *v.* Bangs, 34 Mich. 304.

force and collect the full face value of such collaterals as against the parties, being responsible to the pledgor for any surplus, after payment of the debt and proper charges. The actual recovery of the pledgee is limited to the amount of the principal debt, with interest, as where a deposit was made as collateral security of scrip certificates for money due at the United States Treasury under a treaty,[1] and of a non-negotiable certificate of deposit in a bank.[2] Where the payment of bills of exchange were secured by a non-negotiable bond, the recovery on the security was limited to the amount of the unpaid bills, with interest from maturity.[3] An unpaid call on shares, assigned as collateral security proved insufficient because of misappropriation. The pledgee was allowed to claim in insolvency proceedings the unpaid portion of his debt against the company.[4] Upon the proceeds from property covered by a pledge of dock warrants, about the ownership of which there was much litigation, proving insufficient to discharge the principal debt, the pledgee was allowed to prove not only the unpaid portion of his debt, but his costs in the litigation.[5] A fund was deposited with a third person to hold as collateral security for the performance of a contract to buy land, give mortgages, and build houses. After some work had been done, the project was abandoned, and the proceeds of the sale under foreclosure proved insufficient to pay the debt. The person for whose benefit the collateral fund was deposited was given so much thereof as would put him in as good a plight as if the houses had been finished.[6] A mortgagor assigned a lease, with privilege of renewal, as collateral security. Upon default and foreclosure, a deficiency occurred. As against a subsequent pledgee of the rent due

[1] Baldwin *v.* Ely, 9 How. 580.
[2] International Bank *v.* German Band, 71 Mo. 183.
[3] Orr *v.* Churchill, 1 H. Bl. 232.
[4] In re Kit Hill Tunnel Co., L. R. 16 Ch. D. 590.
[5] Ex parte Carr, L. R. 11 Ch. D. 62.
[6] Kidd *v.* McCormick, 83 N.Y. 391.

under the lease, the prior pledgee was preferred until his debt was fully paid.[1]

§ 448.—Payment and discharge of Pledgor.—The pledgor of non-negotiable collateral securities is entitled, with other pledgors, to a return of his securities, upon payment of the principal debt. He is also entitled to the benefit, upon settlement, of any sum which has been collected by the pledgee on the non-negotiable choses in action held by him as collateral security, and to which the pledgor would be entitled upon payment of the debt.[2] The lien of a pledgee of a chattel mortgage, held to secure the payment of a debt, is discharged by a tender of the amount due by the debtor or his representatives.[3] The acceptance of a conveyance of real estate as collateral security for the payment of a judgment, is not a satisfaction.[4] But after a full settlement between the parties to the contract of pledge, and release of all claims, where the collateral security was an insurance policy, the pledgor will have no claim to return premiums subsequently paid to the pledgee.[5] No presumption arises where non-negotiable certificates of deposits are held in pledge, that such paper was intended as payment, in the absence of express agreement,[6] nor where there has been a deposit of fire insurance policies as collateral security. The mere receipt of them is not a payment.[7] The pledgor is not entitled to a return of insurance policies given as collateral security for the payment of a bond and mortgage, where a release of the mortgage has been recorded, so long as the bond representing the debt remains unpaid. The right to retain such collateral securities enures also to the benefit of assignees from the pledgee.[8]

[1] Storey *v.* Dutton, 46 Mich. 539.
[2] White *v.* British Empire Ins. Co. L. R. 7 Eq. 374.
[3] Haskins *v.* Kelly, 1 Robt. 160.
[4] De Clery *v.* Jackson, 103 Ill. 658.
[5] Merrifield *v.* Baker, 11 Allen, 43.
[6] West *v.* Carolina Ins. Co. 31 Ark. 476.
[7] Scott *v.* Lifford, Campb. 246.
[8] Hollis *v.* Insurance Co. 12 Phila. 331.

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